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10 Adelaide Street East, Toronto

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THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

ANNUAL MEETING OF 1942

Announcement was made in the June issue of THE CANADIAN CHARTERED ACCOUNTANT of the Fortieth Annual Meeting of The Dominion Association of Chartered Accountants to be held in Calgary 17th to 19th August next. The sessions of this meeting and of the several committees will be held according to the following schedule:

17th August,	Morning	—Meeting of Executive Committee
	Afternoon	—Meeting of Council
	Evening	—Meeting of Committee on Education and Examinations
18th August,	All day	—Meeting of Council, continued
19th August,	Morning	—Annual meeting of members; reports of committees
	Noon	—Luncheon—Address "Reconstruction after the War" by Principal Cyril F. James of McGill University
	Afternoon	—Golf tournament
	Evening	—Dinner (informal).

AUSTIN H. CARR,
Secretary-Treasurer.

20th June 1942

Editorial Comment

(Contributed)

Corporation Funds

"Purchasing power" is taking the limelight in the financing of our wartime economy and particularly at the present time when specific steps are being taken to control prices. As the problem of inflation becomes more acute attention will be necessarily diverted to the modern corporation and particularly to the position of the industrial manager and his relationship to the funds which pass through the channel of the corporation.

The main sources of funds for the industrial corporation management may be separated into the two general divisions—internal and external. The chief source of internal funds is from net profit, supplemented by such funds as may arise from charges made to operations in determining the net profit which do not involve a current outlay of funds, as in the case of depreciation. The main sources of external funds are from the sale of the company's shares and bonds and from both long and short term borrowings.

In the corporation, funds are being constantly poured into a central reservoir from which the management is empowered to draw and use as it sees fit, governed of course by existing priorities and regulations. Already steps have been taken by governmental agencies, through powers granted under *The Excess Profits Tax Act*, to channel off substantial amounts of the increased funds arising as a direct result of the increased war activity before they reach this central reservoir. An alternative step to attain the same end would have been to allow the added funds to reach the central reservoir and to absorb the equivalent by a tax imposed on the persons to whom the funds may be diverted by management—that is, by a personal income tax on the recipients of dividends.

The primary consideration from the standpoint of inflation in respect to the reservoir of funds which is subject to industrial management's decisions as to its use is to determine ways and means of sterilizing such funds. To accomplish this an examination should be made as to the manner in which the industrial manager may apply this purchasing power.

Management Decisions

The type of decisions made by the management may be subdivided into two categories —decisions which involve the direct use of funds, and those which involve merely a transfer of funds, the use or spending of which is left to the discretion of the persons to whom the transfer is made. The first subdivision of decisions will involve purchases of inventories, supplies and fixed assets, whereas the other subdivision will include the payment of cash dividends, repayment of bank loans and funded indebtedness, a reduction of capital stock or a purchase of investments.

Through the restrictions in the form of priorities which have already been imposed on new capital construction and the building up of non-essential inventories, a decided brake has been placed upon the decisions of the industrial manager which would involve the direct use of the funds at his disposal. The following extract was taken from the annual report of the directors of *Canadian Cottons Limited* to the shareholders for the year ended 31st March 1942 which will serve as an illustration of the above-mentioned situation.

> The necessity of diverting a larger part of our production to war requirements during the year has resulted in a corresponding reduction in the flow of goods to regular trade channels, and secondary manufacturers, who are depending on these goods as their raw materials, must curtail operations accordingly . . . . The difficulty of effecting normal machinery requirements owing to the necessity of giving priority to the production of war munitions is also an important factor in maintaining production.

As yet there have been no direct steps taken in regard to the management decisions involving a transfer of funds. Transfer decisions usually concern the individual who as a recipient is more likely to use such funds directly. The restrictions against the direct use of funds as applied to the individual are not yet as stringent as in the case of the corporation.

Neutralizing Corporation Funds

An examination of the type of decisions of industrial managaments involving the transfer aspect leads to an evaluation of steps which have been taken in effectively neutralizing the funds which have come under the control of management and which might be diverted by them into the transfer channels.

The direct transfer of such funds by management to governmental agencies has answered the question of one means of neutralization. This has been accomplished by "investment" purchases in the form of government securities, the carrying of bank balances in the form of a long term investment and the repayment of bank indebtedness. The latter method is governed by the assumption that the policies followed by the banks as to commercial and industrial loans will be so designed as to control inflation.

Direct restrictions may be placed either on the use which could be made of the funds taken from the reservoir for transfer purposes or the actual freezing of the funds within the reservoir. The extent to which direct restrictions might be utilized would of course be modified by existing conditions as in the case of placing a limit on dividends to be paid. Specific restrictions might be placed on both the repayment of indebtedness other than to governmental or governmental-controlled agencies and the purchase of investments other than in the form of government securities. The question of the freezing of funds may be applied to depreciation reserves, such as, requiring that these reserves be maintained in the form of deposit account balances which cannot be utilized until such time as the release of such funds will be beneficial to the fiscal policies of the country.

Depreciation

Depreciation has arisen as a factor in the periodic measurement of income. It is essentially a procedure by means of which a given cost incurred in the purchase of a fixed asset whose life extends beyond a single income period might be allocated over the life of the asset in the determination of accurate periodic costs. Although no actual funds are provided by the process of accruing depreciation, it is through the revenue stream of realized production that such funds are provided.

The problem of depreciation from the standpoint of the accountant is relatively simple in that it merely represents a procedure of allocating certain periodic costs to revenue. The rate of depreciation on the fixed asset is determined by the firm at the time the asset is purchased, weighted by certain technical considerations. The question of the financial administration of depreciation is a purely management problem.

There appears to have arisen a somewhat divided opinion on the part of auditors as to the degree to which they should be prepared to accept the responsibility of expressing an opinion on the adequacy of the reserves provided for depreciation in any given case. Qualifications are sometimes inserted in the audit report where an apparent discrepancy as to the adequacy of the depreciation provision exists, for example, "In our opinion, subject to the adequacy of the provision for depreciation (as to which we are not in a position to express an opinion) . . . ." In certain other cases where the rates of depreciation allowable by the income tax department in computing net taxable income are most prevalent, a general specialized opinion is accepted as adequate, and no qualification is considered necessary.

Depreciation Rate Determination

Although the auditor is justified in accepting a specialized opinion upon the question of depreciation rate determination, he still has available over the life period of the asset or assets being depreciated criteria by means of which he is able to judge the adequacy or inadequacy of the rates of depreciation used by management in the determination of the periodic income. The criteria referred to are the debits or credits arising from over, or under, provision for depreciation in prior periods. These may take the form of specifically recorded profits or losses on the disposal of assets or undisclosed profits represented by assets still in use which have become fully depreciated.

A decline in the annual provision for depreciation without a corresponding decline in the level of production, such as may occur when assets become fully depreciated but still remain in use, appears to face the auditor with the question as to whether or not he is called upon to pass an opinion on the specialized opinion which he originally accepted on the matter of the depreciation rates applicable to the fully depreciated assets. The answer to the problem appears to hinge upon whether the auditor, given criteria of evaluating a specialized opinion, should qualify his report under circumstances where his findings differ from those of the specialized opinion.

Incentive for Workers and Management

The second war budget presented by Sir Kingsley Wood to the British House did not indicate the degree of appreciation which was expected as to the serious adverse effects which the existing system of income tax and excess profits tax have had on production. The post-war credit (20%) allowed as a form of forced corporate savings under the British excess profits tax act was made statutory "subject only to its not being used for dividends or for the issue of bonus shares." A concession was also granted in regard to married women's earnings in the form of an increased exemption. These concessions represent the major steps which were taken in the budget to relieve the "adverse effects." Finance was placed by no means at the service of production.

The question of the creation of an incentive by the manipulation of the tax structure was referred to by Dr. Funk, president of the German Reichsbank. He points out that the plea for "more incentive at the margin" brought about by a reduction in taxation on overtime pay, etc., rests on fundamental dishonesty since a nation in wartime cannot afford to give extra material satisfaction. He also claims that such incentive is psychologically fallacious since the worker who gets too much money is liable to slack off when he cannot spend it—"a lowering of the will to work." An examination of the system of forced savings which was placed in operation in Britain to counteract the objections raised when the 100% excess profits tax was imposed on business and when there was a drastic lowering of exemptions in the personal income tax field provides a possible answer to one if not both of the objections raised by Dr. Funk. Savings still appear to retain a degree of incentive in the democratic countries.

DIRECTORS AND AUDITORS

Editor's Note: The Economist **(London) is published weekly and is widely read. The following article taken from its issue of 11th April discussed the inadequacy of the normal company statement to reveal to the shareholders and others interested in the company's affairs the results of its operations, and what the directors and the auditors can do to remedy the situation.**

THE demand for reform, for new methods and, most of all, for a fresh outlook, are the order of the day, and while these are—or were—most urgently needed in the highest spheres, there are humbler fields where they are equally desirable. Of these, one is the whole matter of the presentation of the accounts of joint stock companies and the general attitude of company directors and auditors to their responsibilities. There is nothing new in the plea for reform in this matter. It has been pressed, with a very modest degree of success, ever since the habit of investment spread from the wealthy few to a considerable portion of the population. What is, perhaps, new is that, while in the past it was urged primarily as a duty to the shareholder, now it is apparent that the duty is no less due to the other partners in industry, both labour and the actual management, and indeed to the whole community. The last is entitled to ask at least this in return for the privilege of limited liability which it grants to business enterprise. The need for reform does not stop short at the presentation of intelligible and truthful accounts, but to secure a real improvement in this field would go some way both to facilitate other reforms and to remove many misconceptions.

The minimum information which must be given by any public joint stock company is governed by the Companies Acts. The methods of presentation and, to some extent, the actual amount of information given, are decided by the company's auditors in consultation with the directors. Substantial improvements in the Acts have been secured in the past twenty years, and in the same period the profession of accountancy has grown in stature. It remains the case, however, that legislative action has lagged behind the demands presented, while it is axiomatic that, even had these been fully incorporated in the new provisions, public opinion would have moved ahead so far as to leave them behind by the time the changes became law. In an attempt to overcome this disability of legislation, the New Issues Commit-

tee of the Stock Exchange has made its requirements for granting permission to deal in new issues much more stringent, but this excellent reform has been rendered temporarily nugatory by the decision of the Government itself to provide the financial backing necessary for wartime extensions of physical capital. Meanwhile, the ukase against the disclosure of EPT provisions and the necessary ban on the publication of the actual nature and extent of operations have often been used by directors still further to curtail the information given, either in the accounts or in their statements.

It is not necessary to postulate the increased secrecy of wartime accounting to find ample evidence that the normal company statement tells something which is far less than the whole truth even to those who understand it. To extract the maximum from accounts it is necessary for the figures to be interpreted in the light of some expert knowledge of the peculiar conventions of the profession and to make adjustments in the light of external evidence. Even the improvements in law and practice have for the most part been designed to ensure that the picture was not painted in too roseate hues rather than to secure an exact statement of the true position. The broad outlines of this convention have long ago filtered down to the workers. They are, perhaps, even less equipped than the shareholders to disentangle the truth, and it is small wonder if the worker tends to regard the necessary adjustments and explanations of the more instructed as "wangling" designed to deceive rather than as attempts to enlighten. Surprising or not, that is the case; and the misconception is so complete that many of those who are engaged in doing their share to earn the profits of industry believe that the absolute amount going to the owners of capital is proportionate to their labours, although all too often there is a tendency for the reverse to be the case. Such an attitude is good neither for morale at the present time nor for good relations between capital and labour, either now or in the critical years of reconstruction.

Past experience shows that normal legislative machinery is too dilatory to provide a remedy. Here, as elsewhere, what is required is a change of attitude on the part of company directorates, assisted by an alteration of the status

of the auditor. It is perhaps inevitable that "absentee" ownership—the normal accompaniment of joint-stock finance today—should mean an inability to exercise control over policy, and thus to encourage the belief among directors—in all but a few notable exceptions—that the business is theirs to do with as they will and that their duties are discharged by the payment of a reasonable dividend. It is quite clear that the Companies Acts envisaged neither such remoteness of control nor the apathy of investors as to the conduct of their affairs. It is a somewhat ironical position that it is quite likely to be the demands of labour which will persuade the director to give that accurate account of his stewardship which, in theory, the law has always guaranteed to those who risk their capital in the enterprise. The law never appears even to have contemplated that there was any such duty to the employee, though it is only fair to say that in some cases both management and directorate have realized the existence of this duty, and have fulfilled it—with highly gratifying results. It is also only fair to state that there are companies which give much more information than the prescribed minimum, just as there are others which adopt every legal expedient to withhold information which the law intended to be disclosed.

The few company directorates who publish full and reasonably truthful accounts and who explain them in some detail both to shareholders and to their workpeople, with a brief survey of the main conditions affecting the past and future operations of the company, set an example which should be universally followed. It is not proposed for the moment to set out in detail the reforms which are requisite, but leaving on one side balance sheets, the figures of profit should be given in such a form as to provide a test of the relative efficiency of the management, and the net amount available for the proprietors should be disclosed, without concealing adventitious aids or tucking away secret reserves against a rainy day. Further, the nature of the appropriations from this figure, and in particular the extent to which they are provisions for past liabilities or future possibilities, should be clearly stated. This would, of course, entail revealing information about the company which directorates have in the past considered essential to conceal from their competitors. But the intelligent competitor can, if he thinks it worth while, secure, without much expense,

more information than the most intransigent workman or shareholder is likely to demand.

In the execution of such reforms the auditor has a crucial part to play. Legally, he is the servant of the shareholders, who appoint him yearly. A famous judicial dictum defined his position as that of a watchdog, not that of a bloodhound. These canine metaphors are out of date. It is even rarer for auditors to be changed at the request of the shareholders than for directors to be unseated. The auditor does his duty as he sees it, but he tends to see it rather from the standpoint of the board, or at least, relying on the dictum, to leave with the directors responsibility for imperfections which offend neither the law nor the canons of accurate accounting.

If the duty of the directors is to render an account of their conduct of the company's business, that of the auditor is to make clear the financial results of operations. These should be stated in language which demands only the minimum of special training for its interpretation, and they should be neither so voluminous as to be difficult to assimilate nor so imperfect as to leave undisclosed matters of any considerable moment to those concerned. Finally, it would seem desirable to abandon the practice, usually considered sound hitherto, of understating the true profit position. The published profit figure should be one which comes as near the truth as is possible, having regard for the fact that valuations of most assets and liabilities are matters of estimation rather than of mathematics.

As the law at present stands, the auditors are servants of the proprietors. It might be that if they were asked to put their duty to the public first, this would conflict with their legal obligation to the shareholder. There is in consequence a not unnatural desire on the part of some sections of the profession that accountants should be given *de jure* the status of public servants. That is, perhaps, a desirable objective. It is less clear that it is desirable to confer official standing upon a body of people who have still to show, in many cases, that they appreciate the nature and extent of duties, very different from those hitherto performed. It is, in fact, doubtful whether any change from without can do much to assist—it certainly cannot replace—a determin-

ation on the part of the profession to view their duties in a broader light.

It is, however, virtually certain that some directorates will see real damage to their shareholders' interests in the fuller publicity demanded, and it would be unfair to put the whole responsibility for enforcing reform on the shoulders of the auditor. He should see that the spirit, not the mere letter, of the law is fulfilled, but the law should insist on much fuller information. It is not too early to start planning what these reforms should be, and there would seem to be no reason why the relevant authority should not now enforce the publication of full profits, before "secret" reserves, as an earnest of its readiness to assist. This would, presumably, have to be subject to the existing ban on the publication of figures before EPT, although the utility of this provision in the national interest is open to doubt. Pending these reforms, the difference between the "best" accounts and the least informative is already so great that an insistence on a closing of the gap by improving the latter would, in itself, be something of a revolution. This is a matter for co-operation between directors and auditors.

A PLEA FOR GREATER FRANKNESS IN FINANCIAL PRESENTATIONS

By W. G. Leonard, Chartered Accountant, Kingston, Ontario

A LONG, careful and painstaking search through the published financial statements of large corporate bodies would be required before the searcher might stumble upon the word "estimate" or one of its derivatives and, if it were found, it probably would be buried somewhere in a voluminous footnote. Accountants seem to avoid the word as if it were a plague. If, however, we were perfectly frank or honest with ourselves, there is no word which should be in more frequent use in the body of and even in the headings over published financial statements.

In the life of any business concern, a year is far too short a unit of time to permit of correct measurement of annual income with anything approaching mathematical certainty. This is true even where books are kept with meticulous care and scrupulous honesty. It may be possible when a

business finally is wound up, the assets all converted into cash and the final distribution made, to prepare a statement which will show exactly (in terms of dollars) the results of all the operations of the business. The only drawback here is that the dollar probably has not had the same buying power down the years, so that the figures may still not mean exactly what they seem to mean. But in a year by year accounting such exactitude is rarely possible.

The example which comes quickest to mind is that of inventories of merchandise, work in progress, or raw materials. Published studies have shown that methods of valuation are neither exact nor uniform as between different business concerns. Even if standards were established (which they are not) the valuation of the inventory of the individual concern would still be a matter of estimate upon which expert appraisers might, in all honesty, disagree.

A sub-division of this same problem upon which disputes have waxed long and loud is the method of application of factory overhead (in manufacturing concerns) to the work in progress inventory. The problem is merely mentioned as there is no intention here of trying to solve it.

The point which the writer will try to make however is that accountants as a whole show a lamentable lack of moral honesty when they write down the words "Net profit from the year's operations" without any use of the word "estimated" or without any warning to the layman that the inventory figures were "taken" or "estimated" by the company's own officials with only a very slight independent check on quantities, none at all on quality, and very little on valuations. Extensions and footings will usually have been test-checked. The most that can be hoped is that the basis was "consistent with that adopted in previous accounting periods." A certificate usually is taken that this is the case.

How many financial statements are there which do not tend to understate earnings in "good years" by the use of unstated inventory "reserves?" And is it not "good business?" And how can any accountant, in practice, know how large these are and when they are utilized in the "leaner years?" And does not the inequitable income tax law which measures taxes on a one-year basis make it neces-

sary for some businesses to do this as well as to make a disproportionate amount of "repairs" in the good years?

All these things are well known and much debated. For the accountant "appeasement" did not begin at Munich.

Depreciation

And what about depreciation of fixed assets? Theoretically, depreciation (as distinguished from obsolescence) is an engineering problem. A particular building or machine will under certain conditions and subject to a certain production rate have a certain life-expectancy. The cost to the business of the fixed asset is the original cost minus the scrap value received and this is a direct cost of operations over the period of its useful life. To this calculation must be added "something for obsolescence." If everything is correctly forecast, the depreciated book value will at the end of the life of the asset exactly equal its scrap value and the "net profit from operations" for all the intervening fiscal periods will have been correctly stated.

But how many businesses have a competent engineer plan a depreciation schedule at the time when a fixed asset is acquired and try to work out depreciation on a scientific basis? Do not the majority use rather the maximum "income tax" rate in "good" periods and 50% of the rate in "bad" ones? And on how many financial statements does one see the wording "Estimated depreciation of fixed assets," or even any explanation of the basis of the estimates?

The Consolidated Balance Sheet

Another serious matter is the presentation of the income statement in connection with the consolidated balance sheet of a corporation which has control of the assets and command over the policy of a large section of an entire industry. It seems to the writer that such a statement is unintelligible even to an expert accountant unless it is accompanied by copious explanatory notes and numerous explanatory schedules. How then is it possible to present it as a verified statement of the facts with no qualifying phrases whatsoever?

Probably the only honest method of presenting many financial statements annually would be to accompany them with an explanatory note worded in some such manner as the following.

"We present the minimum information which the law requires. Its preparation was a complicated matter, necessarily done in a hurry, in the course of which a great number of estimates had to be made in order to ascertain the portion applicable to the year immediately past of many revenue and expense items not exactly measurable on an annual basis. We have employed expert accountants to certify that the estimates are reasonable. A statement is attached of the method used by us of making the most important of these estimates in order that you may be able to compare the results of operations of the current period with those of previous periods or with those of other concerns in which you may hold shares."

Has any reader yet seen a financial statement presented in this manner?

No Exact Measurement

Usually, published statements carry a grand air of finality. The balancing is worked out to the last twenty-three cents and the facts are presented in such a manner as to appear to have the finality of the laws of the "Medes and the Persians." The impression conveyed by the lay-out of the figures is that here is a concern which does not need to go into petty details in order to give the impression of grim, silent strength comparable with that of the Rock of Gibraltar. The audit report must be in the "short form." To use a greater number of words in order to give an exact statement would be little short of treason and would be resisted vigorously by the directors.

In the opinion of the writer, these things must end if members of the profession are ever to educate the public away from the childish notion that accountancy is akin to simple mathematics in that the facts may all be assembled in definite and undisputable array and an exact measurement obtained therefrom. Accountants must be ready not only to admit but to insist upon the fallibility of the statements for which verification is requested. They must emphasize more and more that their certificate is a statement of opinion based upon the facts. But the thing which they should do and which they have not yet done is to insist that there be set out in detail a statement showing which of the alternative methods of measuring certain types of revenue and expense items has been used where there are other

equally reasonable methods which might have been used and where the reader can have no understanding of the method of income measurement in the absence of such a statement.

Are the directors and auditors of limited companies sufficiently honest with the shareholders when the published financial statements fail to do this? The writer feels that in most cases it is a matter of "style" or tradition to present these statements in the conventional manner and that there is no real intention of refusing to fulfil the spirit of the law by fulfilling merely its letter. The profession as a whole, in some measure, fails to heed the warning of Lord Justice Lindley in *Re London and General Bank, Limited* that "an auditor who gives shareholders means of information instead of information does so at his peril," and again that "the duty of an auditor is to convey information, not to arouse enquiry."

SOME NOTES ON WAR FINANCE IN GREAT BRITAIN

Including Taxes on Companies and Individuals

By Bryan Pontifex, F.C.A., F.R.Econ.S., London, England

THE budget for Great Britain was introduced in the House of Commons on 14th April last. It has not yet been passed into the 1942 Finance Act but it may be taken that the budget proposals will be generally adopted and appear on the statute book.

Limited companies are again to pay income tax at 10/- in the £ on all profits. As nearly all dividends are declared and paid "less income tax," companies, *qua* companies, are as it were largely recouped by the amounts of tax they deduct from their shareholders' dividends. This is straightforward but there are additional and supplemental taxes on limited companies although they are exempt from the surtax paid by individuals with incomes over £2,000.

The Finance Act 1937 imposed the "National Defence Contribution"—surely a euphemism for taxation! This was originally intended to be in operation for five years to 31st March 1942 and the national defence contribution had become, in effect, complementary to the excess profits tax.

But they are really alternatives—the higher of the taxes as computed is the one payable. This last budget did not permit the National Defence Contribution to lapse; it is to continue "from year to year until parliament otherwise determines." The rate of the national defence contribution is 5% on net profits in the case where the business is carried on by a body corporate and at 4% in any other case.

The principle of the excess profits tax sounds simple. Originally the government took the whole of the profits made by companies during a war year in any excess of profits over those of a pre-war standard period. This was found by companies, manufacturers especially, to be altogether too drastic. It allowed of no additional provision or reserves in respect of immediate post-war years adjustments and no increase charge for depreciation although necessary, due to longer hours of machine working caused by munition-making-contracts occasioning two or more labour "shifts" a day. Arithmetically easy but fundamentally unjust! *The Finance Act* of 1941 reduced this 100% rate to 80% but levied the full 100%, the balance being retained by the government as a "post war credit" for the company, to be repaid by the government after the termination of hostilities, but even then the refunded amount is to be treated as taxable income of the year in which it is refunded. The 1942 budget did not alter this. It should be noted in comparing the alternative national defence contribution and the excess profits tax that exemption from the contribution is granted in respect of any trade or business whose profits in any period of twelve months are not more than £2,000. It should be noted also that the rule is that the amount chargeable in respect of the national defence contribution and the excess profits tax are treated as expenses of the trade or business for the year in which the respective accounting periods end and will "normally operate" to reduce the amount chargeable to the income tax for the following year of assessment. National defence contribution and excess profits tax together will bring into the exchequer £425 millions during the ensuing year or about 17½% of the "total receipts from taxes."

As regards income of individuals, the standard rate for 1942-43 is the same as 1941-42, namely, 10/- in the £ on the taxable income. First the actual income figure is taken

and from that if "earned" a deduction is made of 10%. Then there are deductions from the actual income of personal allowances—£80 for a single and £140 for a married man and £25 in respect of a dependent, if any, and £50 for each dependent child. Then of the taxable income the first £165 does not pay 10/- but 6/6 in the £ and after that only is the 10/- rate applied. Again from the tax so computed there is an allowance re life insurance premiums paid. So that the tax, although of course heavy, is not so bad as it sounds. Surtax has superseded the former super-tax and that begins at 2/- in the £ (10%) on incomes over £2,000 per annum, rising to 9/6 in the £ on very large incomes. Surtax is, of course, an addition to income tax; so very rich men pay altogther 19/6 in the £. Income tax yields £913 millions and surtax £78 millions, together nearly £1,000 millions—not bad for a population totalling altogether only forty million people!

Income Tax for Wage Earners

This was an innovation last year. Trade unions had always contended that all taxes should be "direct" (income tax and the like) none "indirect"—that is on beer, tobacco, tea, etc., the argument being that a working man's beer cost him as much as a millionaire's and so on. When the income tax level was reduced (this exemption is now on incomes below £110 per annum) wage earners, being human, changed their minds and there has been for a year a howl—long and loud—against their income tax, largely, of course, because few workmen could understand the mode of assessment and collection decreed necessary by the Inland Revenue. Employers advise the Inland Revenue of the wages earned in a half year by each man; the employee advises as to the number and constituent of his family and also as to other income if any, and the Inland Revenue issues a precept on the employer to deduct one twenty-fourth each week of the tax assessed in respect of the earnings of the previous half year in the ensuing half year. It will be appreciated that it will take much explanatory patience to convince 5,500,000 worker-taxpayers that they are suffering no injustice. Thousands of married women are now "engaged on munitions" and there is now an additional tax-free personal allowance of £80 in respect of married women's earnings.

Purchase tax is now generally 33⅓%, but the tax on

some articles has been raised to 66⅔%. This tax brings in some £90 millions a year.

Altogether the Chancellor estimated a total expenditure in 1942-43 of £5,286 millions, being an increase of £510 millions over the actual expenditure of 1941-42. Awful! But it's an awful war!

The use of the word "billion" has been abstained from here on account of its different significance. In Canada a billion is a thousand-million; in Great Britain, a million-million. The former enumeration is useful but the latter useless, even for the government's present astronomical figures, for even they have not yet attained a million-million!

The heavy and rising taxation is being met philosophically. The government is financing the "World War" better than the "Great War." Now it borrows money at 3% and deducts at 10/- in the £ income tax from the interest; then it borrowed money at 5% and the income tax did not, until 1918, exceed 5/- in the £. The total war bill—largely because of increased mechanization—will be very much heavier than that of a quarter of a century ago.

AUDITOR'S ADVENTURE IN NORWAY AT OUTBREAK OF WAR

By Pilot Officer E. Harris, Chartered Accountant, formerly of London, England

Editor's Note: Readers will note that at page 270 of our April issue, Pilot Officer E. Harris of London, England, was guest recently at an evening meeting of the Regina Chartered Accountants' Club. Pilot Officer Harris was in Oslo, Norway, on audit work for Messrs. Price, Waterhouse and Company, at the time of the German invasion. He reached Canada via Sweden, Russia and Japan, where he boarded the Empress of Asia bound for the Dominion. He joined the R.C.A.F. shortly after his arrival here and is now an instructor at the Regina airport. He has written also of his adventures in Russia.—A.H.C.

THE evening of 8th April 1940 appeared to any ordinary observer to be much the same as any other evening in Oslo. The cafés were all in full swing; the Bristol Bar was well patronized; the revolving search-light rays of Langaard's tobacco sign illuminated the dark April sky. There was, however, some tension in the air. The previous day it had been reported that the British had laid mine-fields in Norwegian territorial waters. The evening papers had

reported a large number of German ships of all sizes moving up the Skagerrak. One of these ships had been torpedoed off the south coast, and it was rumoured that the bodies of many armed soldiers had been washed ashore.

It was in this atmosphere that I went to bed in my room in the Hotel Bristol at about 11:30 p.m., and having had a busy day I was fast asleep when the air-raid sirens started sounding their short danger signals at 12:30. I put on my overcoat and went out onto my little balcony to see what was happening. My colleague, J.S., was on the adjoining balcony, and after discussing the situation we thought that it was probably a precautionary measure on the part of the authorities to get the city blacked out in case of trouble. For about ten minutes nothing happened at all; the people in the streets were standing about in little groups at the corners discussing this latest excitement, but no attempt was made to put any lights out until a man came running along the street shouting "put out your lights!" Shortly after this the street lights went out, and one by one, district by district, the gay blaze of lights which was Oslo was slowly extinguished. An hysterial woman started weeping in the street below; everywhere was an undercurrent of subdued voices, audible in the silence created by the stopping of the traffic. Perhaps an hour passed before I realized I was getting cold, so I got back into bed again in that impenetrable darkness. Sleep was now far away, and it was with much relief that I heard the "all-clear" signal some hours later.

There was another alarm and all-clear signal during the night, and a third alarm sounded at about 6:30 a.m. By this time it was daylight again, and the electric power had been switched on, so I turned on the radio to try to get some idea of what was happening. It was not until 7:15 that I heard the B.B.C. news, and learned that Copenhagen had been occupied by German troops, and that the British fleet was standing by. No mention was made of Norway, but at 7:30 I heard from the Oslo station that Narvik, Trondheim and Bergen had been occupied, and troops landed at several other points on the coast. Warships had made their way up Oslofjord, one of which had succeeded in passing the formidable fort at Oskarsborg. I thought that some sort of action seemed now to be indicated, and as a first step I went to call J.S. next door. My friend is a

heavy sleeper; it took some minutes to stir him to consciousness at all, and still longer to make him realize that some form of conscious activity was needed of him; as to making him understand that the Germans were rapidly approaching Oslo, that was quite out of the question, so I turned his radio on for him to hear with his own ears as soon as the next announcement was made a few minutes later. The next announcement was in fact a little more cheering; the cruiser which had succeeded in passing Oskarsborg had gone aground. The next development was, however, by no means reassuring; it was the sound of aeroplane engines, and in a few seconds I could see them, flying low over the roof-tops, not a hundred yards from my window. They were three light bombers with "that black and double cross" on their wings, and the swastika on their tails. A few machine guns were being fired at them, and a few minutes later, when more planes came over at a greater height, the anti-aircraft guns (both of them!) came into action. It was just at this time that I heard splashes in the bathroom J.S. and I shared; apparently no German 'planes were going to interfere with his bath!

There was a knock at the door, and one of the hotel porters told me that I was supposed to be downstairs in the shelter, because there was shrapnel flying about from the anti-aircraft shells. I passed this information on to J.S. in his bath, and got dressed as quickly as I could.

On arrival downstairs I found that most people were not in the shelter at all, but were eating their breakfasts in the grill. I waited for J.S., and we decided that they were probably right, and we ate as much as our rather shaky appetites allowed, wondering when and where our next meal would be.

After breakfast we tried to telephone to a friend in the British Legation, and we learned that the whole legation staff had left at 7:00 a.m., accompanying the Norwegian government to Hamar. There was no reply when we tried the Consulate, and so we thought we had better fend for ourselves, and not expect any official help.

Working Papers for Future Reference

We now walked to the office at which we had been working, and collected as many working papers as we could carry. After that we could think of nothing better to do

than to look around the town and try if possible to find out the real state of affairs, and whether there was any way of getting to a more healthy neighbourhood. We had already been told by a friend that we could go up to his house at Holmenkollen if things got too hot down in the town.

At about midday we were eating a little lunch at Telle's Café in Fritjof Nansenplass, waiting for our friend to arrive to take us up to his house in his car. Suddenly the whole building was shaken by a terrific explosion; the first bomb had been dropped, on the quayside just below Akershus. The next fifteen minutes were spent underground, but as there were no more bombs, we came up again and finished our lunch. A short time later our Norwegian friend, E. T., arrived with the cheering news that the Germans were at Lysaker, only half an hour away from Oslo. On the way up to Holmenkollen we passed through a line of Norwegian soldiers, and we wondered if they were going to put up any resistance to the advancing Germans.

Holmenkollen lies about a thousand feet above sea level, about two or three miles out from the centre of the city. It commands a fine view over the whole district. Consequently, we could see everything that was happening in the air over Oslo, and over the aerodrome, which lies behind a low hill due south of our viewpoint. This is the aerodrome at Fornebu, which had been captured by the Germans earlier that morning after a short aerial engagement.

The radio was now sending out announcements that Norway had capitulated without a fight in the same way as Denmark. As we had no reason to believe otherwise, and we certainly had not seen much sign of resistance ourselves, we took this to be the truth, and assumed that it would be merely a matter of time before the invaders started rounding up the British residents they could lay their hands on. There seemed to be no way out. At five o'clock, however, we heard the news from the B.B.C. that Norway was resisting, somewhere north of Oslo, and that statements to the contrary emanated from the German controlled news sources, included in which was the Oslo transmitter. It was shortly after this—we were trying to play bridge to steady our nerves—that another explosion down in the town shook the house. We could see from the balcony the smoke of two bombs which had fallen just outside the

central part of the city. There were a number of Nazi 'planes about a thousand feet above that district, and as we watched, two more bombs were dropped close to the first ones; others followed—I counted ten in all. The following morning the newspapers, now controlled by the Nazis, stated that they were British 'planes which had bombed Fröen.

That evening we did some pretty hard thinking. E.T. went down to the town to scout around for us, and returned with the news that all foreigners at Slemdal Hotel had been taken off by the police, but that the Bristol, Grand and Continental had not yet been visited.

The decision that we finally came to was to wait until the morning, when E.T. would go down to the American Legation, which had taken over British interests, and ask their advice. And so we tried to get a little sleep.

The following morning (Wednesday, 10th April) we could hear occasional machine-gun fire from the hills around, and felt very glad we had not attempted to get out that way the previous night. At about 10 a.m. we saw a cruiser, followed by four destroyers and several small craft, steam up the fjord and tie up at Vipetangen. At about 10:30 there was another air-raid warning, just before E.T. arrived back from the American Legation with the astounding but welcome news that we could leave quite safely by the midday train to Sweden, but that if we waited until the night train it might be too late. Consequently, we decided, air-raid or not, to try to get to the hotel to collect a few belongings as quickly as possible. On the way down we had to stop once when three 'planes of a type we had not seen before came over. We hoped they were British, but they were too high to see any markings, and there was no shot fired against them, although all other 'planes had disappeared from the sky. They came over the hills from the south-west, and after circling the city once they dropped something with a small parachute over the aerodrome, and flew off in the direction from which they had come. We then continued down towards the town, but had to stop again when we came to an air-raid warden. It was here that we saw our first German soldiers, in green uniforms, with automatic rifle and a belt full of hand grenades.

An errand boy came past on a bicycle, shouting to us as he passed that everybody had to leave Oslo by midday.

We did not know what that meant, so we drove on until we came to Drammensveien, one of the main roads out of Oslo. Here the most extraordinary sight met us. The road was packed with vehicles of all sizes and descriptions, and with people walking and running away from the city, many burdened with what personal possessions they could pick up in their hurried departures. Many women were weeping and screaming hysterically; children were wandering about crying for their lost parents. It was quite impossible to drive against this stream, so we turned into it, and after picking up a full load of women and children we returned, safely, thanks to E.T.'s excellent driving, to the house we had left shortly before.

Soon after our arrival, it was announced over the radio that it was a false alarm; everyone was to return home. But still the cars streamed out, in an unbroken line which only slackened at about three o'clock, at which time we returned to the city, this time without interruption.

We went straight to the Bristol Hotel, had the hall porter accompany us upstairs, asked him to get us tickets on the train, in Norwegian names, and then we packed our belongings. The hotel's van had been commandeered, and so we could take with us only what luggage we could ourselves carry to the station. The train was not due to leave until 8:10 p.m., and we occupied some of the time in collecting the rest of the working papers we had not been able to take the previous day. And we also had a meal hidden away in an obscure corner of the Grill, speaking only Norwegian, of course. E. T. had to leave us before the train departed so as to be home before the blackout.

Leaving for Sweden

At last the time arrived to leave the hotel. We paid our bills, and tipped the porter. J.S. was ready first, and on going through the swing doors was confronted by a whole squad of German soldiers, lined up right outside the hotel. By the time I was ready a man had appeared on the steps of the Hondverkeren building opposite, and was addressing the soldiers in German. J.S. was much relieved by this as he had thought they had come to search the hotel.

The station was crowded. There were two soldiers standing around, but they took no interest in the passen-

gers. The train was late coming in, and we went straight to our sleeping compartment, determined to speak only Norwegian to each other until we had passed the Swedish border—if we were ever lucky enough to get that far! We were rather surprised to find most of the occupants of the neighbouring compartments speaking English without restraint; they were neutrals, mostly Swedish and Dutch. At the frontier we were presented with the usual forms to be filled in concerning our reasons for visiting Sweden, and the intended length of our stay.

At Charlottenburg, the first stop in Sweden, we breathed freely again for the first time in two days, and went on to the platform for a breath of fresh air. The first person we saw was a friend from the Consulate in Oslo, who told us that there was a whole coach-load of Britishers forward in the train, including the vice-consul, leaving with full knowledge of the German authorities, who had been approached by the American Legation.

In Lapland

It was towards the end of May that we first realized nothing was coming of the Consulate's scheme of repatriation of the Britishers in Stockholm who wished to leave. There were four of us in Price, Waterhouse & Co. who were anxious to get home to find more useful employment than ticking Swedish books. After enquiry at the Legation and the Consulate we discovered that it was quite possible to go privately up to the North of Norway, and there to find some means of transport to England. It will be remembered that at this time the Allied forces had just retaken the Port of Narvik.

It took us a week to obtain the necessary visa for Finland, and consequently it was not until Thursday, 6th June, that our famous expedition got started. The party consisted of J.S., W.H. and J.J. besides myself; all Scottish except me.

Our train left "Centralen" at 2:15 p.m. and there was quite a party of friends to pat the engine, and say a fond farewell. Mr. F.T., our resident partner, I remember, was last seen demanding 10 öre back because he had been refused admission to the platform after buying a platform ticket.

There was only one incident on the train worth record-

ing. We had to change trains at a place called Ange, and I was stupid enough to leave my ticket, right through to Rovaniemi, in the train we had left. By a miracle (which the Railway Company called efficiency) it was returned to me at our next stop. We breakfasted next morning at Boden, the stronghold of North Sweden. At Tornio on the Finnish Frontier, we had to pass the customs and censor, still on a wartime footing.

We arrived at Rovaniemi at about midnight, very sore from the hard third-class seats. There was no taxi to be had, so we had to walk the half mile to the Pohjanhovi Hotel, with our luggage, which consisted of a *rucksack* and a small case each, except for W.H. who had a large suitcase as well. We arrived at the hotel to find it full, but as soon as they realized we were British, they made up beds for us in a room off the dining room.

Next morning we met a friend from Stockholm, a fellow chartered accountant, trying the same way home as ourselves, with two naval fellows taking a diplomatic bag about the size of a side of bacon. They also had an American in their party, booked to leave on a Finnish boat from Petsamo. These four had arrived the day before, and were continuing in the bus, which was by now all booked up. However, we were lucky; we met a Norwegian who was in charge of a whole fleet of trucks taking supplies up the Arctic Highway to North Norway, and returning with goods for Finland from the ships discharging at Petsamo. He arranged for us to travel with these trucks the whole way to Salmijarvi, where we were to take the ferry across to Norway.

We had time before we left to have a hurried look round Rovaniemi, and see the damage done by the Russians. Many buildings were completely levelled with the ground, and I did not see a single building undamaged. Glass was very scarce and most windows were still covered with cardboard. We saw the famous General Wallenius having breakfast with his daughter at the hotel.

Within the Arctic Circle

J.S. and I got away in the first truck, closely followed by J.J. and a Norwegian announcer also on his way to England. W.H. was to follow later in a third truck. Crossing the big bridge over the river our driver pointed out a hole made

by a bomb which had passed clean through a steel girder without exploding. A few kilometers outside Rovaniemi we passed a notice board marking the Arctice Circle. We stopped for a cup of tea at a little town we came to after two hours of driving. The truck with J.J. arrived a few minutes later. When we had finished, the driver showed us a stick of dynamite he had found in the tool box of the truck behind ours; he said it was the kind used by the Norwegians for blowing up bridges. To the consternation of his two passengers he replaced it in the box. We soon got moving again, but the next time we stopped for a cup of tea, about three hours later, the other truck did not appear, although we waited for twenty minutes. We did not wait longer, however, but drove on, and arrived at the tourist inn at Ivalo at about eight o'oclck, where we were to stay the night.

A word may here be said about the great work being done by these Norwegian and Finnish drivers at this time. The famous Arctic Highway was in rather bad condition, having been subjected to such hard wear so soon after the melting of the winter snows; in fact driving on it compared rather unfavourably with riding a particularly lively bucking broncho. And yet these fellows were driving up and down the five hundred kilometer stretch from Rovaniemi to Petsamo, often in twelve-hour shifts. Added to the discomfort of the bumpiness was the continuous cloud of dust on the crowded road and the glare of the midnight sun hanging low on the horizon at night on the northward journey.

Neither J.J. nor W.H. had turned up by 11 p.m. and, as we intended to start again by 8 o'clock next morning, we went to bed. We were down to breakfast early on Sunday, 9th June—a date I shall not forget easily. There were three travellers eating breakfast who had only just arrived, and I noticed in the vestibule what appeared to be a British diplomatic bag. These three people were talking Danish and Norwegian alternately. One of them introduced himself to us seeing that we were English, and told us he was British Consul General to North Norway, and that he had just come from there because the allies had evacuated the whole of Norway, and that we had better return to Stockholm. His companions were French and Danish Consular officials. They soon left for the south in their car.

The name this man had given us was not familiar to us; the whole story sounded quite preposterous, and we had heard much about fifth column activity on this road, so we decided to carry on and see for ourselves at the frontier, after our driver had telephoned to his headquarters for instructions and been told to carry on.

While all this was going on, J.J. and the announcer had appeared. Their truck had turned over in the ditch, and they had had a few very unpleasant seconds while the tool box containing the dynamite had been banging along the side of the road. They had been picked up by the bus, and arrived at about 2 a.m. There was no sign of W.H.

The morning was fine, but cold after the more southerly latitudes we were used to. There was now only one truck, so J.S. and the announcer sat in the cab, and J.J. and I sat on top of the load of potato sacks. As we got further north, the cold got worse, and although we both had skiing clothes on, the icy air, from which we had no protection, seemed to cut right through us. We gave two soldiers a lift for part of the way; they were very friendly when they understood we were English, but conversation was rather limited as they knew no English, and only one appropriate sentence in Swedish—är du kall t?—are you cold? This they pronounced "är du galt?"—are you mad? We hopefully assumed it was the former they meant and replied with a most definite affirmative.

At Nautsi we had to produce passports and permissions for the military authorities, and from here on we began to see more and more signs of the war, a burnt out plane, a Russian uniform, a whole forest cut down, leaving short stumps as tank hinders, and the rough shelters the Russians had used to try to keep off the worst of the arctic weather. It was here that 600 Finns had been holding a line against 50,000 Russians, when peace was signed.

We arrived at Salmijärvi at midday. W.H. was there waiting for us. He had left Rovaniemi shortly after us in an old truck which, it was discovered, could not climb the hills without assistance. They had got a more powerful truck to tow them up the first hill, and when they reached the top the driver apparently forgot he had anything on tow, and went driving on at about 45 km.p.h. The result was inevitable. The first truck they met going in the other

direction knocked them over into the ditch. Luckily no one was hurt, and they all continued in the remaining truck, and drove straight on through the night, arriving at Salmijärvi at 9 a.m. Here W.H. had been informed that the frontier was closed to all but Norwegian subjects.

We could not help laughing at the sight of dear old W.H., unshaven, grey with cold, dressed in a smart blue overcoat and Anthony Eden hat, with his luggage beside him, looking for all the world as if he were waiting for a train at Waterloo. Surrounding him were the charred ruins of what had once been a flourishing little township of nearly a thousand people, hundreds of miles north of the Arctic Circle.

There was now nothing to do but return to Ivalo as soon as we could get some means of transport. This, however, proved none too easy; soon refugees started coming over from Norway, Danish and other volunteers, and civilians, including women and children, who of course were given the first available accommodation. There were at this place only one tent and three wooden huts, two of which were occupied by officials. The third was a sort of doss-house, with a kitchen giving out hot tea, apparently all they had, and with wooden shelves round the walls for the residents to sleep on. There was no other accommodation available north of Ivalo, every single house having been destroyed, either by Russian bombs or by the Finns themselves before retiring. It started snowing, and we all had to stay out in the open air in the biting wind with frequent cups of tea, and brandy, which we luckily had with us. We also had plenty of food in our *rucksacks*.

At eight o'clock in the evening, a bus left, but we were not allowed to take it, as we had by now become mixed up with the refugees, and the overworked officials would not let the party split up. We were all to leave together in an escorted convoy of trucks. There was only one man who spoke a few words of English, and another a word or two of Swedish, so our protests were quite unavailing. The trucks finally got started at about midnight, the four of us with three or four others in the back of the same truck we had come up in, now empty, endeavoured with a tarpaulin to keep the worst of the rain off, but which we found only served to keep the engine fumes in. We had difficulty in persuading the authorities to let us stop at Ivalo, as the

rest were being taken on to Rovaniemi, direct. We were all in pretty bad shape with the fumes and bumping on the hard boards, and the cold, but except for J.J. who caught a cold, we had all recovered by the time we had had a few hours sleep.

Home Via Iceland?

We now got in touch with the other fellows we had met in Rovaniemi. They had been to see the military authorities, and had arranged for us all to await a week to find out if we could leave with one of the boats from Petsamo to Iceland or America. So we all moved over to another hotel, at Inari, 40 km. west of Ivalo. We had a car and an orderly at our disposal, and a young officer to look after us.

The weather turned fine, and our surroundings were very beautiful. The hotel stood beside a fast river, with good fishing, and surrounded by the Lapland forests, with many pleasant walks. The sun was warm enough for sun-bathing 24 hours each day, if we had wanted. Some of us even bathed in the river the last few days. The days passed pleasantly enough; we luckily managed to fix up the hotel radio so that we could hear news from home—and what news, the collapse of France, Dunkerque, and the entry of Italy into the war.

After a week we were told we could not get away from Petsamo, and that we had better return to Stockholm. We went to Rovaniemi by bus this time, and that was bumpy enough for eight hours. We stayed one night at the Pohjanhovi Hotel, and found that Sweden would not permit us to return through the north of the country; we must go down to Helsinki and fly across. We stayed a couple of days in Helsinki, and W.H. and J.J. stayed there on a job, while J.S. and I returned to Stockholm on the 23rd of June.

GLIMPSES OF CURRENT ACCOUNTING LITERATURE

A Summary Prepared by John Douglas Campbell,
Chartered Accountant

BULLETINS

(1) Cost Accounting

BULLETIN No. 17, Volume XXIII, section I, 1st May 1942, published by the National Association of Cost Accountants (New York) presents a statement by William W. Werntz on the considerations which led to the selection of the type of financial report form and a summary of the principal requirements of the report adopted by the Office of Price Administration (O.P.A.).

The report forms referred to represent the establishment of an initial program of interim and annual reports to be filed by American business corporations (approximately 25,000) with the O.P.A. designed to furnish that department with general financial information as a background for the more specific detail of enquiries as to prices, unit costs and other data relevant to the problems of price control.

The report forms were drawn up by the O.P.A. in consultation with committees representing the four national accounting associations—American Institute of Accountants, American Accounting Association, Controller's Institute, and National Association of Cost Accountants.

Section III of Bulletin No. 17 presents a tentative statement on accounting for excess labour costs arising directly from the defence program made by the research and technical service department of the National Association of Cost Accountants.

The problem is stated as essentially one of inventory valuation applying specifically to companies manufacturing for stock. The conclusion is drawn that the costs under consideration—overtime premiums, night shift premiums and costs resulting from employee-training programs—represent a proper exception to the general rule that all production costs are properly assignable as "product costs" to the values placed on inventories. The suggestion is made that it appears more logical to treat these excess or added costs as "period costs" to be written off currently rather than as

"product costs" to be carried forward in inventories. Where the current cost of the product does not exceed normal cost there would appear to be little necessity for excluding the added costs from product costs.

In referring to the application of these added costs to jobs or contracts the conclusion is drawn "to spread these costs over all production *pro rata* through inclusion in overhead, in labour standards or through separate *pro rata* application."

Bulletin No. 18, Volume XXIII, 15th May 1942, covers two industrial accounting problems arising from the war on the specialized subjects of motion and time studies and the destruction of old records.

A. E. Werolin in an article, "The Cost Accountant and Time and Motion Studies," outlines the general nature and purpose of the motion and time studies and indicates their particular significance in our present emergency.

Ernest A. Davis discusses the subject "The Destruction of Old Records as a Wartime Measure," in which the questions of economy and organization form the keynotes. "No record must be allowed to create filing expense, unless there is a strong probability that at least part of this expense will be recovered."

The following factors are laid down as essential to any plan for destruction of records: (1) a schedule of destruction dates which covers all records as far as possible, (2) periodic checking and revising of this schedule, (3) passing judgment promptly on items not covered by the schedule, (4) provision for the proper housing of records while they are retained, and (5) provision for policing the committee's rulings.

ARTICLES

(1) Internal Audit Review

Victor Z. Brink in an article, "The Independent Auditor's Review of Internal Control," published in the May 1942 issue of *The Journal of Accountancy* (New York), presents the results of a survey of current practice on the nature and methods of the review made by auditors of the system of internal control.

In setting out the general nature of the problem, the historical background of auditing is presented bringing out

clearly the interrelationship between the developments of internal control and the audit program. "That which was once a subordinate part of the audit, or in a sense an adjunct to it, is in many cases now considered an important division of the program." The review of the internal control has become a necessary part of the audit program in order to determine the form of that program. The more extensive a company's system of accounting and internal control, the less extensive will become the detailed checking of the auditor.

The major portion of the survey report hinges about the nature and content of the instructions to be followed in making the review and the manner in which the results of the review should be presented.

Although the survey of practice indicated the reflection of individual judgment as to the methods applied and the adaptation of the methods chosen to given sets of circumstances, certain preliminary or tentative conclusions were drawn. The greater dependence placed upon the system of internal control has made the review one of the important problems of the profession. As the review of the internal audit customarily forms the groundwork for the plan of the audit program, it is advisable that the review be made prior to the balance sheet date and be co-ordinated with the complete audit program. The reviewing should as far as possible be done by the staff men entailed to the particular sections of the audit. Written instructions of some kind are desirable but they should be flexible enough to allow full scope to the ability of the accountant making the review.

Finally the maintenance of some form of audit report on internal control review is stressed as being desirable.

(2) Market Profits-Operating Statement

Chas. F. Schlatter in an article, "Market Profits on the Operating Statement," published in the April 1942 issue of *The Accounting Review* (Chicago) indicates by case examples the manner in which the conventional accounting operating statement may fall short of revealing significant facts to management, shareholders and creditors under circumstances where market profits or losses exist.

The suitability of the last-in, first-out basis of inventory valuation in overcoming the difficulty is considered. The

conclusion is drawn that, although the last-in, first-out method reveals the operating profit or loss clearly, it does not reveal the supplementary information as to market profits or losses. The suggestion is put forward that the use of the last-in, first-out method of inventory valuation has been adopted in many cases as an indirect result of the conventional operating statement not revealing market profits and losses distinct from operating profits and losses.

A suggested form of operating statement is presented to meet the situation upon which both market profits or losses and operating profits or losses are revealed. No departure is required from the normal application of accounting principles to accounting procedures although certain monthly statistical records relative to current market prices must be maintained as an aid in computing reproduction cost of sales. "This method comes much nearer to matching current prices of materials with current prices of sales."

(3) Taxation—Transfer of Powers by Provinces

Theodore Kraft in an article "Canada Alters the Fiscal Relationship between the Provinces and the Dominion" published in the April 1942 issue of the Bulletin of the National Tax Association discusses the retirement of the provinces from certain fields of taxation and the compensation by the Dominion for the loss of revenue by means of an annual sum or subsidy.

The details of the Dominion proposal are set forth and the similarity to the recommendations of the Royal Commission on Dominion-Provincial Relations indicated. Although the provinces in signing the agreements have not "surrendered, transferred or impaired" their rights under the *British North America Act*, the proposal does provide the Dominion with an opportunity to institute for a trial period a portion of the Commission's report which will no doubt act as a strong argument in favour of the implementation in full of the Rowell-Sirois Commission report at a later date.

The difficulties which are encountered by a "federal" state in financing a war are outlined and it is pointed out that the plan of the Dominion Finance Minister is "an effort to produce order from chaos." The plan not only stabilizes the provincial revenues at a point enabling the

individual provinces to carry on their normal functions but also places the major sources of revenue in one authority, enabling the greatest revenue to be obtained with the most equitable distribution of the burden. In essence the Dominion has the advantages of public finance which a unitary state possesses and which are of particular significance in a wartime economy.

(4) Audit Report

The following extract taken from the accountant's report to the Board of directors of the Dominion Gas and Electric Company (U.S.) serves to indicate one type of situation which is considered necessary of recognition as not being consistent in principle with the preceding year.

". . . . in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year except for the change in treatment of unbilled revenue as set forth in Note 3 to the consolidated balance sheet . . . ."

"Note 3: Unbilled revenue is stated in the foregoing balance sheet at fixed amounts carried on the books of the subsidiaries whereas in prior years (when net variations in unbilled revenue were more important in relation to income) it was the practice to reflect in the consolidated accounts the net effect of the increment of estimated unbilled revenues over such fixed amounts. The discontinuance of this practice as of 1st January 1941 has the retroactive result of reducing consolidated net current assets as of 31st December 1940 by $75,316.15 which is offset as of that date by (1) reducing earned surplus of subsidiaries as at acquisition by $86,553.97 and minority interest by $1,767.47 and (2) increasing earned surplus of subsidiaries since acquisition by $13,005.29."

THE WAR RISK INSURANCE ACT

By G. R. G. Baker, Toronto

Editor's Note: Mr. Baker has been a contributor to these pages on a number of occasions. He is a graduate in Arts (University of Toronto) and in Law (Osgoode Hall, Toronto). He is the Secretary of The Land Mortgage Companies' Association of the Province of Ontario.

THE fact that the war is drawing closer to our shores is accentuated by the introduction in the Canadian parliament of a bill to enact *The War Risk Insurance Act.* With the single exception of the Halifax explosion catastrophe of 1917 Canada, at the time this bill was introduced in Parliament on 27th March last, had suffered no war damage to property for over a century and there had been no need for legislation of this kind.

The necessity for war risk insurance as a government responsibility arose as a result of the action of insurance companies and underwriters in refusing to insure against war risk, following the attack of the Japanese upon Pearl Harbour on 7th December 1941. Prior to that date there was available in Canada insurance against war damage to property.

The bill as presently drawn provides for a voluntary scheme of insurance under which every home owner will be entitled to free compensation for war damage, in respect of a dwelling which he occupies, up to $3,000. Compensation in respect of chattels will also be paid. In the case of a householder who is married compensation for chattels may be paid to an amount of $1,200, subject to increase for each child by a further $100. An unmarried householder may only receive $800, and any person other than a householder $200.

This compensation for damage to property and chattels will be paid without any premium having been given, but if coverage is desired for a larger amount a premium must be paid and a policy of insurance issued by the government agency.

In order to secure the best and cheapest operation of the plan, it is intended to enlist the aid of fire insurance agents and companies through whom war risk insurance policies will be issued and claims adjusted if they arise.

The bill is in skeleton form and such questions as premium rates, maximum coverage, terms of insurance and other

matters will be determined by regulations to be decided upon after the Act is passed.

It will be apparent that the free compensation contemplated by the bill is an attempt to provide for essential shelter and necessary household goods, and this is to be provided by the country as a whole, for those who are so unfortunate as to be the casual victims of war damage. Beyond this point the person who may have an interest in property must insure and pay a premium, although the premium will be at the same rate whether the property insured is located in the relatively safe areas of the middle provinces or in the more dangerous areas on the east or west coast.

Compensation is to take care of immediate needs and may be used at once to repair damaged properties, to render them habitable or even to secure other properties to live in, where damage either cannot be repaired or where it may be undesirable that it should be repaired or the property replaced. In the case of insurance payments, however, the benefit will probably not be forthcoming until the end of the war.

In Great Britain, the United States and New Zealand, as well as other countries, various schemes of war risk insurance have been adopted, and the Canadian plan does not follow closely the pattern of any of them. Some schemes provide for the payment of all damage by the state. Some permit established insurers to reinsure a part of the risk with the state. Others make a levy upon all property to create a fund out of which compensation is made to those suffering damage, and a fourth class makes provision for the citizen to protect himself by taking out insurance with the government at a low rate.

Great Britain in some measure has adopted all four methods. Canada is following the first and last methods at present, but at some future date, if the plans now contemplated are found to be inadequate, a compulsory form of insurance may be required, and the experience of administration gained in the interim will be useful in formulating the new plan to be followed.

THE ACCOUNTS OF EXECUTORS, ADMINISTRATORS AND TRUSTEES

Memorandum for Passing of the Same

(*Note:* The following memorandum has already been in effect in Alberta for some years, and is published here for the information of the readers of *The Canadian Chartered Accountant.*)

In order to obtain uniformity and facilitate the audit of accounts it is suggested that accounts of executors, administrators, guardians and trustees should be presented in the following order:

1. Schedule showing in detail assets disclosed on application for grant
2. Schedule showing additional assets (if any)
3. Schedule showing in detail liabilities disclosed on application for grant
4. Schedule showing additional liabilities (if any)
5. Capital account, Receipts
6. Capital account, Disbursements
7. Revenue account, Receipts
8. Revenue account, Disbursements
9. Reconciliation account (where necessary)
10. Schedule showing assets remaining on hand (if any)
11. Schedule showing liabilities unpaid (if any)

In accounts where it is not necessary to separate capital and income, 5 and 7, and 6 and 8 respectively may be combined.

The accounts showing receipts should be detailed under the following headings:

Number of item
Date
From whom received
Particulars
Amount

The accounts showing disbursements should be detailed under the following headings:

Number of item
Date
To whom paid
Particulars
Amount

The schedule of assets should be detailed under the following headings:

Number of item
Particulars
Disposition of assets

Under the heading "disposition of assets," the disposition made of the particular asset, with a cross-reference to the entry in the account, should be shown. For example, if it is delivered pursuant to a specific clause or bequest the fact should be noted. If the asset is sold, reference to the item number or numbers showing receipt of the proceeds in the accounts should be made.

The Reconciliation Account should show in summarized form the items necessary to balance the net value of the estate at the commencement of the period with the net value at the end. It should open with the net value of the estate at the commencement, and there should be shown therein particulars of all transactions whereby the value of the estate is increased or diminished.

The closing balance should then agree with the net value of the estate at the end of the period.

The accounts should be verified by an affidavit, which should also contain details of any matters in connection with the administration that are out of the ordinary and appear to require explanation.

(Signed) V. R. JONES,

Clerk of the Supreme Court of Alberta
Clerk of the District Court of the
District of Southern Alberta.

INCOME AND CORPORATION TAX

Some Further Notes on the Tax Convention between Canada and the United States

IN the April issue (pages 246-250) we published the text of the announcement made in the House of Commons, 5th March last by Honourable Colin Gibson, Minister of National Revenue, respecting the tax convention signed between Canada and the United States on 4th March 1942.

The following extracts are from a discussion on the convention when this agreement was considered by the House of Commons (in committee) on 8th June last.

Mr. Gibson: This convention was signed on 4th March. On the following day I made a statement in the house outlining the terms, or the chief terms, of the convention, and so probably it is not necessary to give a lengthy explanation today. It might, however, be advisable to give a brief review of the deductions at the source as between Canada and the United States as they have existed and been modified by a prior convention and as they are modified by the present convention.

In 1933, for the first time Canada imposed a 5 per cent tax deduction at the source in respect of dividends and certain interest leaving Canada. It was not until three years later that the United States first imposed a tax deduction at the source in respect of certain periodic payments made to persons resident outside of the United States. In 1936, when the United States imposed a 10 per cent tax deduction at the source it was felt that representations should be made to reduce that to 5 per cent so that there would be parity of deduction between the two countries with respect to these periodic payments. As a result, the convention of 1936 was entered into, and from that time until 29th April 1941 the deduction at the source of each country remained at 5 per cent.

In April 1941 Canada raised its rate of tax deduction to 15 per cent, and in so doing automatically abrogated the existing convention. As a result, the then existing law in the United States pertaining to deduction at the source applied equally to Canada, as it did to all other parts of the world. The law of the United States required a deduction of 16½ per cent, and thereafter 16½ per cent was deducted in the United States.

However, the United States government then raised the tax deduction rate from 16½ to 27½ per cent, so that during the last three months of 1941, 27½ per cent was deducted at the source from periodic payments originating in the United States and payable to Canadian resident holders of United States securities, as compared with the deduction at the source in Canada of 15 per cent.

A Member: If this convention goes through, will it operate to revert to the former rate, and will there be refunds covering that period?

Mr. Gibson: Yes, it will give us refunds not only of the difference between 15 per cent and 27½ per cent, but also of the 16½ per cent rate that existed from April 1941 when we changed our rate from 5 to 15 per cent. When we did that, the United States rate automatically applied to Canada.

This discrepancy in the amount of the deduction at the source again became the subject of negotiations with a view to parity of deduction. The negotiations culminated in the convention which has been tabled, and which was signed on 4th March 1942 by our minister at Washington, Mr. Leighton McCarthy, and the acting under-secretary of the treasury, Mr. Sumner Welles.

This convention, as my previous statement indicated, is wider than the prior convention of 1936. Broadly speaking, it does the following:

1. It reduces the United States tax deduction at the source from 27½ per cent to 15 per cent, and is retroactive, so that parity of deduction as between the two countries has been restored.

A Member: From what date?

Mr. Gibson: From April 1941, the date when we abrogated the prior treaty.

2. Certain extra-territorial features of the United States law as they impinged on the Canadian taxpayer are eliminated. By way of example, the United States law imposed a tax on any Canadian company, 50 per cent or more of the revenue of which was derived from sources within the United States, if the income was accumulated by a recipient Canadian company. Or again, if a Canadian company had 50 per cent of its revenue from the United States, then

any Canadian individual resident who received dividends from that company was liable to taxation under the United States extra-territorial law. These extra-territorial features have been eliminated.

3. For the years prior to 1936, the United States revenue officials have been seeking to collect taxes on gains said to have been made by Canadian individuals and companies transacting business through Canadian brokers on the exchanges in the United States.

Many of these claims antedated 1929. Many of our Canadian residents, if they did make some profits prior to 1929, suffered substantial losses thereafter, and I am informed, were called upon to pay their United States obligations; so that in the result, in some instances more money was paid into the United States than ever came out.

A Member: Do I understand that heretofore the United States treasury has sought to impose on Canadian nationals taxes in respect of capital gains made by Canadians operating through United States brokers on the stock exchanges in New York or elsewhere?

Mr. Gibson: Yes.

A Member: On the theory that capital gains and capital losses are taken into consideration under their income tax law, while in Canada they are not. Has Canada at any time ever acceded to that position, and what was the result? Did these people have to pay? I had not known that the United States government had actually taxed Canadian nationals resident in Canada on capital gains.

Mr. Gibson: There have been a great many claims, some of which have been settled, others of which have not been disposed of. As a result, Canadian taxpayers have not been sure whether the United States government was going to endeavour to collect from them or not. With this convention these claims are being dropped, and the only claim now being made by the United States government is with respect to the tax on any dividends or interest received on moneys invested in the United States.

A Member: Does this cover taxes that were paid by some Canadian nationals prior to the settlement? Will such taxes be refunded? It seems to me they should be, in justice.

Mr. Gibson: No; there is nothing in the tax convention

providing for the refund of moneys already paid. Perhaps I might continue with my statement, which deals with these matters.

Representations were made to the United States government that such claims be not made, and for some time they were in fact not made. However, after 1932 the United States revenue officials actively sought to collect taxes in respect of these old transactions. These claims were resisted by Canadian taxpayers on the ground that they were not carrying on business in the United States, that they were not subject to the revenue laws of the United States, that they had been informed that the claims would not be made, and in fact they were not made for many years but were, as stated, subsequently revived. Now by the convention these claims are settled on the basis of the 1936 law as modified by the 1936 convention; that is, in general, 5 per cent in respect of any dividends or interest received from United States securities, and no claim in respect of any capital gains on stock market transactions. Any person in Canada who wishes to take advantage of this convention must, within two years from the date of this convention, apply to Washington for a settlement on the basis outlined. Therefore all persons concerned should take note of this requirement. Otherwise the law as formerly asserted by the United States might now be imposed as against those who fail to make such a settlement.

A Member: Why should that be necessary? Why should not the government deal with it?

Mr. Gibson: Those cases are still outstanding; there was a liability under United States law, and they can still proceed against the taxpayer if they desire to do so.

A Member: If the cases are going to be dropped, why should that not be done by express arrangement under this convention?

Mr. Gibson: Under the terms of the convention the taxpayer who is liable under the earlier laws must file returns so that they will know he has made a disclosure of the interest he received during that period.

4. If there is any case of double taxation arising by reason of a United States company doing business in Canada, or *vice versa*, and the company by reason of the apportionment of profits is being taxed on more than 100 per

cent of its profits, it can ask for a conference between representatives of the two governments with a view to securing an adjustment.

5. The convention also provides for an exchange of information pertaining to the payment of dividends, interest and other fixed periodic payments. This provision does not require Canada to give information respecting the income of residents of Canada.

6. If the authorities of one of the contracting states are under the belief that the other country is being used as a basis of perpetrating fiscal fraud, a request for special information may be made pertaining to the activities of any such person, and after consultation the information may be exchanged. This is designed to preclude evasion and fiscal fraud.

NEW LEGISLATION RESPECTING TAXATION— DOMINION AND PROVINCIAL

Summaries of the recent Provincial legislative Acts, implementing the agreements between the Dominion and the Provinces for the suspension of certain taxes in wartime, were published in the May and June issues of THE CANADIAN CHARTERED ACCOUNTANT.

Amounts of Compensation by Dominion to Provinces

The Parliament of Canada has now passed *The Dominion-Provincial Taxation Agreement Act 1942* which gives authority to the Minister of Finance to enter into an agreement with the government of any of the provinces of Canada "to provide, in accordance with and subject to such terms and conditions as may be set out therein, that the province and its municipalities shall cease to levy personal income and corporation taxes as defined in such agreement and subject to such exceptions as may be set out in such agreement, for the duration of the war and for a certain readjustment period thereafter, and to provide for the payment of compensation by the Dominion to the province therefor."

In the case of the provinces of Alberta, British Columbia, Manitoba, Ontario and Quebec the annual amount of such compensation shall be:

Alberta	$ 4,080,860.64
British Columbia	12,048,367.51
Manitoba	5,054,740.92
Ontario	28,964,039.54
Quebec	20,586,074.56

"being an amount in each case calculated as equivalent to the total revenue obtained by the said provinces from personal income and corporation taxes during the fiscal year of each of said provinces and of municipalities therein ending nearest to the thirty-first day of December 1940 which by the terms of the agreement will cease to be levied."

In the case of the provinces of New Brunswick, Nova Scotia, Prince Edward Island and Saskatchewan the amount shall be:

New Brunswick	$3,278,574.15
Nova Scotia	2,585,308.72
Prince Edward Island	264,769.94
Saskatchewan	4,330,471.29

"being an amount in each case calculated as equivalent to the net debt service paid by the province during its fiscal year ending nearest to 31st December 1940 (not including contributions to sinking funds) less the revenues obtained by the province from succession duties during the said fiscal year."

Any arrears of personal income and corporation taxes collected by a province after the close of its said fiscal year may, in accordance with and subject to such terms and conditions as may be set out in the agreement, be deducted from the annual amount payable to the province and shall be paid to the province after the termination of the agreement.

Additional Subsidies

The agreement may also provide that in the case of the provinces of Manitoba, New Brunswick, Nova Scotia, Prince Edward Island and Saskatchewan, the Dominion shall pay by way of additional subsidy during each year of the term of the agreement the respective amounts hereinafter set forth:

Manitoba	$ 600,000.00
New Brunswick	371,493.30
Nova Scotia	325,769.31
Prince Edward Island	437,174.02
Saskatchewan	1,500,000.00

The agreement may also provide, in accordance with and subject to such terms and conditions as may be set out therein, that the Dominion shall pay with respect to each year of the term of the agreement to the province the amount by which the net receipts during the said year from the tax imposed by the province on the sale of gasoline are less in each case than the following amounts:

Alberta	$ 3,221,975.68
British Columbia	3,763,625.95
Manitoba	2,678,148.64
New Brunswick	2,101,072.01
Nova Scotia	2,853,363.82
Ontario	26,608,290.59
Prince Edward Island	307,901.72
Quebec	11,803,248.13
Saskatchewan	3,397,279.42

"being an amount in each case calculated as equivalent to the net receipts of the province from the tax imposed by the province on the sale of gasoline during the fiscal year of the province ending nearest to 31st December 1940."

The Parliament of Canada at its present session has also passed *The Maritime Provinces Additional Subsidies Act, 1942* to implement the recommendations of the "White Commission" which had been set up in 1934 to consider a revision of the financial arrangements between

the Dominion government and the Maritime Provinces. This Act provides for the following additional annual subsidies to be paid half-yearly in advance:

To New Brunswick	$ 900,000
To Nova Scotia	1,300,000
To Prince Edward Island	275,000

The said subsidies, however, shall not be payable to such province while an agreement under the provisions of *The Dominion-Provincial Taxation Agreement Act, 1942* remains in force with respect to such province.

JUDGMENTS RESPECTING THE INCOME WAR TAX ACT

The National Petroleum Corporation Case
and
The Sterling Royalties Case

IN THESE cases Mr. Justice Maclean, President of the Exchequer Court of Canada, had to investigate charges that the method adopted in 1938 by the Minister to arrive at proper allowances for depletion and development expense for these oil producing companies was arbitrary and not based upon sound principles. Judgment was rendered on 30th May 1942 in the case of National Petroleum, and on 1st June 1942 His Lordship adopted the same reasons for the Sterling Royalties case. In both instances the appeals of the companies from the decision of the Minister validating the assessments were dismissed with costs. The facts discussed are those relating to the National Petroleum Company.

Procedure

The company operated two oil producing wells in the Turner Valley area in Alberta. The allowances claimed for depreciation were conceded without protest by the Crown. The company sought, however, to have the whole balance of its net profit allowed as exemptions and deductions under section 5(a) of the Act under the two heads of depletion and development expense. The amount actually claimed for depletion alone, $54,608.45, was all that the Crown was prepared to concede on both counts. The method adopted by the Crown in determining the amounts of the allowances was apparently more or less uniformly followed in similar cases. Depreciation at varying rates was allowed on plant

and equipment, rotary rigs and well casings, as well as on other physical chattel property. Development costs are not expressly mentioned in the Act but Mr. Justice Maclean concluded that the hole in the ground through which the oil is recovered is similar to a mine shaft and in theory was "plant and equipment." It is difficult to "depreciate" such an asset and the Minister's practice was to determine the amount of the allowance by taking a percentage of the production. The method adopted was to allow a lump sum to cover depletion and development costs and the amount was determined at 25 per cent of the gross revenue after allowing for overriding royalties. In apportioning such lump sum between depletion and development costs a further arbitrary calculation was made. The Minister would allow for depletion 25 per cent of the net income after all other allowances had been made and such amount deducted from the lump sum representing both allowances would leave as balance the allowance for development costs. In 1939 after a conference between taxing authorities and representatives of oil producing companies in Alberta, the Minister agreed to make the allowance for development costs tie in directly with such costs and 30 per cent of the total development costs was to be allowed for the first year and a diminishing percentage for the next succeeding five or six years until such costs were fully amortised.

Contentions

The company contended that, unlike mining, all the development costs had to be incurred before there was any assurance at all that oil would be found. No profit was derived till the oil was found and if no oil was discovered the development costs would be completely lost. It was argued that there were only two fair ways to handle the problem. The fairest way would be to allow the whole of the development costs when production of the well had ceased. Recognizing that this was not feasible the company wished the whole of the development costs allowed as a charge against income until such time as the costs had been completely recovered. Reference was also made to the short life of Turner Valley wells. The Crown submitted that development costs were in reality a capital expenditure and therefore not allowable as an expense. The company's only rights therefore arose under section 5 and

it was submitted that the allowances were reasonable and fair and had been duly determined by the Minister under and in accordance with section 5.

Judgment

Mr. Justice Maclean rejected the suggestion put forward on behalf of the company that to the extent of the annual income the whole of the develoment costs should be allowed until full amortisation had taken place. He stated that, as the Act imposed a tax on net income, it would be virtually nullified by such a procedure. His Lordship held that it could not be said "in all the circumstances of the case, that the discretion of the Minister was exercised arbitrarily or haphazardly or contrary to the provisions of the Act or contrary to well-established practice or upon what can be said to be obviously unsound principles or that the allowances made can be fairly termed unreasonable, unjust or unfair."

COSTS UNDER GOVERNMENT CONTRACTS

The principles according to which costs may be determined under contracts with the United States government for supplies for the War and Navy Departments have just been set forth in a 30-page pamphlet, "Explanation of Principles for Determination of Costs under Government Contracts," available from the Superintendent of Documents, Washington, D.C., at ten cents a copy.

We understand that the material for this pamphlet was prepared under the supervision of Eric A. Camman, chief, and Maurice E. Peloubet, assistant chief, of the Accounting Advisory Branch of the War Production Board of the United States.

The subject of accounting in connection with war contracts is an important one. Although this pamphlet is prepared for use in the United States, a study of its contents should nevertheless be of interest and considerable assistance to members of the profession in Canada.

The total cost under a contract, according to the pamphlet, is the sum of all costs incurred by the contractor incident to and necessary for the performance of the contract and properly chargeable thereto. The items of cost that

enter into government contracts are classified in logical order in the following outline:

Manufacturing Costs

Direct shop costs:

- Materials and parts
- Direct labour
- Shop engineering expense
- Other direct shop costs

Indirect shop costs:

- Supplies and sundry materials
- Indirect labour
- Service and maintenance
- Fixed charges
- Other indirect shop costs

Other manufacturing costs:

- Amortisation of patents, purchased designs, etc.
- Engineering and development expenses

Other Contract Performance Costs

- Delivery costs
- Installation and servicing costs
- Sundry specific contract costs

Administration and Distribution Expenses

- General corporate and administration expenses
- Bidding and selling and distribution expenses.

It is pointed out that there is no requirement that the contractor shall follow this particular classification in his own system of accounts so long as that system will furnish the information here called for. It is not the purpose of this statement to prescribe uniform accounting methods. It is the purpose to lay down the basic principles governing the determination of costs under government contracts, which principles can be observed by means of any suitable accounting system in accordance with accepted accounting practices.

FOOD RATIONING IN THE UNITED KINGDOM

IN the issue of the 13th June 1942 of the *Commercial Intelligence Journal* (Ottawa), G. R. Paterson, Animal Products Trade Commissioner, London, has explained briefly food rationing in Great Britain.

Food rationing, he states, was introduced in the United Kingdom at a much earlier stage in this war than during the first Great War. The Ministry of Food was established immediately after war was declared, in September 1939, but plans had advanced well beyond the initial stage long before that date through the medium of the Food (Defence Plans) Department of the Board of Trade. The people accepted rationing as a ncessary adjunct to a successful prosecution of the war, and have at all times co-operated wholeheartedly, from the initial stages of simple allotment of relatively few products to the present almost all-embracing scheme. A very complex problem has been handled amidst endless difficulties with marked efficiency. The nation has not only been fed, but it has been well fed. The high standards of work and health bear testimony to these facts.

The civilian food rationing system at present in operation in the United Kingdom may be divided into three parts. First, the foods that are allotted weekly or monthly on a definite scale; second, the foods that are rationed on a method of personal choice but with a maximum total for the group, and, third, the unrationed foodstuffs.

In the first group are included milk, meat, bacon, eggs, cheese, butter, fats, jams or preserves, tea, sugar, and, shortly, sweets. The quantities allowed have been fairly constant but may vary from time to time in accordance with supply. Children under six years of age receive the same amounts of food as adults, excepting meat, of which they get half of the adult ration. Miners, heavy industry workers, agricultural workers and some of the other civilian classes are allowed larger quantities of cheese. School children, invalids, nursing mothers and expectant mothers are provided with extra supplies of milk. When oranges are available children have first choice. In this group registration with retailers is compulsory.

"Points Rationing" Scheme

The "Points Rationing" scheme embraces all foodstuffs included in the second group, i.e. canned meats, canned fish,

rice, sago, tapioca, dried fruits, canned fruits, cereals except oatmeal, dried beans, some canned vegetables, etc. The method has been designed to give some freedom in the selection of products that, although by no means unlimited in supply, are not suited to all tastes. It is very elastic in its application, requires no registration with a retailer, gives choice and variety to the purchase of some of the so-called supplementary articles of diet, and the values can be changed, if necessary, every four weeks' period, depending on supply and demand. At the present time each person is entitled to 24 points per period.

The free group includes: bread and bakery goods; fresh vegetables, excepting onions; soups; fresh, salted and frozen fish; rabbit; poultry; oatmeal; fresh fruit; coffee; cocoa, etc. Fresh tomatoes have been free of rationing but are likely to be controlled this year to ensure that everyone has an opportunity of obtaining a fair share of the production. There has been no scarcity of bread, potatoes and carrots; other vegetables have been seasonally in good supply. Fish has been in short supply and lacking in variety. Fresh fruit has been very scarce. Poultry of all kinds is almost unobtainable.

Price control has been rigidly applied to nearly all foodstuffs and is a vital part of the government's policy to avoid inflation. Evasions of the controls are being met vigorously by prosecutions and heavy fines. "Black markets" and "racket prices" in some things, principally in luxury articles, which are uncontrolled, have been experienced. However, these things, in reality, affect but a small percentage of the public, and they have the remedy in their own hands—refusal to purchase at outrageous prices.

Accounting for Millions of Coupons

In Canada we are just beginning to meet the problems involved in rationing consumer goods. In one of its recent monthly letters, The Royal Bank of Canada points out that businessmen and merchants have as yet little comprehension of the difficulties involved in the mere handling of and accounting for millions of coupons. The British Board of Trade and the banks have evolved a plan to simplify this procedure, particularly in regard to clothing coupons, and the letter gives the following particulars of the plan as

described in some detail by Lord Wardington, chairman of Lloyd's Bank Limited:

> In addition to the other multifarious duties which the banks have undertaken in connection with the war effort, we have recently agreed to operate an entirely new service of a somewhat novel character, which, we believe, will be welcomed not only by the Board of Trade, to whom the conception of the scheme is due and with whom the banks have co-operated in working out the detailed procedure, but also by large numbers of our customers who are concerned with the manufacture, merchanting, and retailing of goods to which the Consumer Rationing Order, 1941, applies.
>
> Under this Order the public have to surrender coupons for all purchases of clothing and footwear, and these coupons have to be passed back from the shops through all the various branches of the trade—the wholesaler, the maker-up, the manufacturer—before each in turn can replenish his stocks.
>
> When one considers that at 66 coupons a year per head of population an issue of close on three thousand million coupons is involved, which at present have to be counted and checked, not once only but three or four times on their journey from the ration-books of the public to the textile mill or the tannery, one can appreciate the amount of labour involved in the mere handling of the coupons.
>
> The scheme which has been evolved and which it is hoped shortly to bring into operation will greatly facilitate the transfer of coupons between traders by reducing to a minimum the irksome labour of counting and recounting the coupons and by obviating disputes and claims for coupons lost, stolen, or destroyed. The coupons themselves will, in fact, only pass from the retailer to his banker and thereafter will be replaced by certified transfer orders. The banks will operate for every trader affected by the Order a separate account in which the currency will not be pounds, shillings, and pence, but clothing coupons. I need hardly say that no overdrafts on these coupon accounts will be permitted.

Coupon Account Records of Traders

According to *The Accountant* (London), in addition to the particulars shown on their counterfoils, traders will be required to keep a daily record of their coupon account showing: (1) *Payments into the account:* the coupon-value of the envelopes and the serial number and coupon-value of each transfer-voucher paid in for the credit of the account; (2) *Transfers out of the Account:* the serial number and coupon-value of each transfer-voucher issued and duly confirmed by the bank. The entries in respect of the transfer-vouchers must show, in addition to the serial number, the name of the customer or supplier as the case may be. The balance as shown by the record must be checked with the bank at least once a quarter. The bank will give the figure verbally, and in case of any dispute will allow the trader to examine its own record of his

account. But arrangements have not been made for the banks to issue any pass-books or written statements of account or certificates of coupon balance, and these must not be asked for. The services of the banks and all the relevant documents are free to traders. The banks will act as agents of the Board of Trade which will pay them a *pro rata* commission. The scheme will undoubtedly impose on them a considerable amount of extra work at a time when their normal staffs are being rapidly depleted, but from the official viewpoint the new machinery should prove a much more effective instrument of control than the old system of exchanging coupons for vouchers at the post office.

TAX EXEMPTIONS FOR LIFE INSURANCE PREMIUMS

The Chronicle, Montreal, in its issue of 12th June dwelt on the importance of life insurance to the average citizen's life-time financial program and referred to the recommendation contained in a recent address before the Seminar on Economic and Social Trends at New York by Roswell Magill, former under-secretary of the treasury and now professor of law at Columbia University. Mr. Magill's suggestion was that legislation be passed to permit deduction before income taxes for premium payments. Such deduction should be limited to a definite percentage of income to prevent its use in unjustified cases for deliberate tax avoidance.

"Under present conditions," Mr. Magill said, "the middle class individual will have little income left after payment of living costs and income taxes. Because of existing tax schedules, however industriously he saves, he cannot build up much of a competence for his dependents.

"Life insurance is almost the only way he can now assure protection of his family. Hence, unless something is done to enable him to carry adequate life insurance protection, the American tradition of individual provision for one's dependents may be broken down, with great loss to the country as a whole.

"From the government's standpoint, it seems entirely logical that investment in life insurance should be encouraged because, like the purchase of War Savings Bonds, it

tends to reduce the possibility of inflation. The money that goes into life insurance premiums is not used for consumption, but for investment in government and industry. As a matter of aid to the country's war effort, it is about as good an expenditure as could be made."

The speaker pointed out that through the years the government has given "strong sanction to insurance through the methods of taxation which have been employed." He referred specifically to the $40,000 exemption to proceeds of insurance policies in the computation of estate taxes.

Money spent for insurance contributes directly to the war program in that the insurance company which receives the premiums will invest a large portion of them in government bonds. Furthermore, money invested in insurance in no way contributes to the forces causing inflation.

Federal taxation measures are being designed to restrict the portion of individual incomes which will be available for consumption and for saving. Mr. Magill said that the purpose of the restriction is twofold:

First, to provide the Treasury with a considerable share of the money required for government expenditures and, second, to reduce the likelihood of serious inflation by eliminating some of the money which otherwise would be actively used in bidding for the reduced amount of goods available for purchase.

"Although it will thus be more difficult for men to purchase insurance, the need for insurance is increased by the very weight of the tax burden."

GENERAL NOTES

Index Figures of Living Costs

According to the Dominion Bureau of Statistics, the cost-of-living index advanced from 115.9 on 1st April 1942 to 116.1 on 1st May 1942. The index has risen 15.3 points (or 15.2 per cent) between August 1939 and May 1942—i.e., from 100.8 to 116.1. (Previous reference—page 401 of June issue).

Table of Exchange Rates

(Kindly supplied by The Canadian Bank of Commerce, Toronto)

	30th May 1942	*15th June 1942*
U.S. Dollars	10-11% P.	10-11% P.
Sterling	443-447	443-447
Australian Pounds	358½	358½
New Zealand Pounds	360	360
South African Pounds	443	443
British West Indies—Dollars	9270	9270
India—Rupees	3356	3356
Hong Kong—Dollars (Custodian rate)	2781	2781
Straits Settlements—Dollars (Custodian rate)	5226	5226
Sweden—Kronor	2637	2637
Switzerland—Francs	2569	2569

Note: The above currencies are expressed as follows: Pound currencies—Canadian cents per unit; Continental currencies and sundry British Empire—Canadian cents per 100 units.

Exchequer Court Sittings

General sittings of The Exchequer Court of Canada for the trial of cases, etc., will be held at the following times and places, provided that some case or matter is entered for trial or set down for hearing at the office of the Registrar of the Court at Ottawa on or before 25th August 1942:

At the court house, Winnipeg, Manitoba, commencing on Friday, 4th September 1942, at 10:30 a.m. (city time).

At the court house, Regina, Saskatchewan, commencing on Tuesday, 8th September 1942, at 10:30 a.m. (city time).

At the court house, Edmonton, Alberta, commencing on Monday, 14th September 1942, at 10:30 a.m. (city time).

At the court house, Victoria, British Columbia, commencing on Friday, 18th September 1942, at 10:30 a.m. (city time).

At the court house, Vancouver, British Columbia, commencing on Monday, 21st September 1942, at 10:30 a.m. (city time).

At the court house, Calgary, Alberta, commencing on Thursday, 24th September 1942, at 10:30 a.m. (city time).

National Selective Service

The Dominion government has revised the regulations respecting National Selective Service, and the following is the announcement issued from the office of the Director of Public Information:

"Extending the government's plan of National Selective Service a new order has been issued providing:

"(1) An employer must notify the local employment office of the Unemployment Insurance Commission when a vacancy occurs.

"(2) The employment office also must be notified when the employer foresees additions to, or lay offs from staff.

"(3) To fill vacancies he must employ a person sent him or approved by the employment office.

"Under the new regulations women are brought within the employment control of selective service. All employment is affected with a few exceptions, such as farm workers, who remain under the order of 23rd March last, which prohibits them from going into any other occupation without a permit from a National Selective Service officer.

"By the measure people with qualifications or skill needed for the war effort will be placed in war jobs where that skill may be used to the best advantage.

"An employer may request that specific persons be approved for vacancies and there is no intention in the order to compel employers to employ persons referred to them, nor is there compulsion applied to force people to work in any specific place.

"There is provision for appealing the ruling of the National Selective Service officer in the local employment office. Any employer, employee, or organization such as an interested trade union or employers' association may

appeal in writing within ten days to the divisional registrar of the National War Services Board. The Board's ruling is final."

Control of Prices and Profits in Australia

A rigid system of price control has been set up by the Commonwealth Prices Commissioner as from 16th April 1942. The chief features of the orders are: (1) prices of all goods and services will be pegged at the levels ruling 15th April 1942, increases can be made only when permission is given to add increased costs under the averaging principle; (2) goods already declared and subject to averaging will continue under the averaging principle as laid down in the new order (new goods declared cannot be averaged without permission); (3) the prices for all services will be pegged at the level of 15th April, but application for adjustment can be made where costs increase.

According to a report of the Canadian Trade Commissioner to Australia, the result of these far-reaching regulations will be the conversion of the Australian Commonwealth to a total war footing and will, in the opinion of economic experts and responsible business executives, result in a marked improvement in Australia's war output. Furthermore, the regulations have been designed to cause as little dislocation as possible and, in view of the critical situation in the southwest Pacific, have been accepted cheerfully by all classes.

In connection with price control, the Prime Minister has announced that it would be the duty of the Prices Commissioner to control prices so that profits would be limited to an average of 4 per cent on capital employed in business as defined by the *Wartime Company Tax Act*. Profits in excess of that amount would be payable in taxation, and the tax would be applied to all companies and to other enterprises the incomes of which, after payment of taxation, are in excess of £1,500 ($5,250) per annum, inclusive of reasonable remuneration to the working proprietors.

Industrial Developments in India

According to a report of Paul Sykes, Canadian Trade Commissioner in India, published in a recent issue of the *Commercial Intelligence Journal* of the Department of Trade

and Commerce, Ottawa, Indian industry has undergone a striking change since the outbreak of the present war, and 1941 was outstanding in the country's manufacturing experience. Developments have been similar to those of the last war, which gave a great and, in many cases, an initial impetus to industrial growth, but many of the recent steps taken to enlarge and modernize existing industries and to establish new ones are of such magnitude as to overshadow completely anything of the kind in the country's history.

Contracts for war materials and equipment for their manufacture have necessitated larger plants, improved methods, and an increase in highly trained personnel on the part of many existing industrial undertakings. Government assistance in various forms has accelerated the development of many new enterprises. The achievements of various new and established industries have been truly remarkable, particularly so in view of the many obstacles to be overcome in obtaining new equipment, in training skilled labour, and in adapting production methods to wartime demands.

Industrialization has long been one of the most cherished ideas of various Indian politicians and economists. The war is bringing this idea to fruition when, under other circumstances, the process would have occupied many long years. Whether or not the development will be for the country's permanent good is problematical, but there is at least no denying that the events of the last two years have been phenomenal, and that the Empire cause has benefited from them to a very important degree.

LEGAL DECISIONS

[*Editor's Note:*—The following are brief summaries of recent decisions of the Canadian Courts as taken, by the kind permission of the Canada Law Book Company, from the *Dominion Law Reports*. In each case reference is made to the volume of the *Reports* where the full judgment may be found. It should be kept in mind that the decisions given may not in every case be final.]

Companies—Power to establish transfer office outside Province

(The King v. *Williams et al.)*

Judicial Committee of the Privy Council

In the absence of an express declaration to the contrary in the Act or instrument creating it, a company incorporated

under the *Ontario Companies Act* [now R.S.O. 1937, c. 251] has the power to establish a transfer office out of Ontario, provided that it keeps the books required by s. 101 at its head office.—[1942] 3 D.L.R. 1.

Income tax—Extension agreement consolidating arrears of principal and interest—Tax on portion representing interest

(re William Ramsay Estate)

Exchequer Court of Canada

The Courts have been astute in holding, in cases where a tax is imposed upon what are in substance and in fact interest payments, that an obligation to pay interest will not be deemed to have been extinguished and a new obligation substituted therefor except upon the clearest of evidence, and that when principal and interest for some cause or other have become mixed up, any payments made may be disintegrated to ascertain what portion, if any, of such payments were on account of capital and what were on account of interest.

A non-resident mortgagee having obtained a final order of sale on the mortgagor's default, executed an agreement granting the mortgagor an extension of time to pay the consolidated amount of principal and interest in arrear at a lower rate of interest, the agreement providing that it was not to prejudice the mortgagee's rights against any party to the mortgage and was to be void at the mortgagee's option on default and that thereupon the mortgagee's right to enforce payment of the principal and interest or to proceed under the final order of sale would revive.

Held, the agreement did not create a new mortgage loan principal but was a mere grant of an extension of time for payment of the sums due for principal and interest on the mortgage with a modification of the interest rate, and the mortgagee was therefore liable under s. 9B(2)(b) of the *Income War Tax Act*, R.S.C. 1927, c. 97 (am. 1932-33, c. 41, s. 9; 1936, c. 38, s. 7) for payment of an income tax of 5% on such part of the mortgagor's payments under the agreement as represented interest on the original mortgage loan.—[1942] 2 D.L.R. 529.

Taxes—Company engaged in oil development—Losses sustained on investments in oil properties— Whether deductible

(re Highwood-Sarcee Oils Ltd.)

Exchequer Court of Canada

A company incorporated for the purposes *inter alia* of recovering oil and dealing in oil properties and of financing other companies, from time to time acquired oil leases but never drilled wells itself or developed such leases. In the tax year 1935 the company received $70,000, being its share of the production of a certain oil lease in which it had purchased an interest, but it sought to deduct some $74,000, being losses which it had sustained on purchases of shares in and advances made to other oil companies in previous years.

Held, the company was not engaged in the business of investing money in oil properties with a view to their resale at an enhanced price but rather with a view to producing a revenue therefrom. Hence the losses above-mentioned were clearly capital losses and not expenditures incurred for the purpose of earning the income within the meaning of the *Income War Tax Act*, and therefore were not deductible—[1942] 3 D.L.R. 38.

PROVINCIAL NEWS

NOVA SCOTIA

At the annual meeting of the Institute of Chartered Accountants of Nova Scotia held Monday evening, 15th June, Harvey R. Doane was elected President and Lloyd J. Wilson, Vice-President. Following are the additional members of the Council: Roy I. Balcom, Harold J. Egan, T. Harold Johnson, Gerald E. Martin, William A. Morrell, James C. Nicoll, Frank A. Nightingale, L. Earl Peverill (Secretary-Treasurer), and Frank L. Silver.

PERSONALS

Messrs. Davis, Boyce & Company, Ottawa, announce that they have opened a branch office in Montreal under the name of Davis, Boyce & Company, chartered accountants, at Room 1411, Royal Bank Building, 360 St. James Street West, Montreal, P.Q.

Messrs. Dunwoody, Nicholl, Saul & Company announce that Mr. John W. Smith, formerly of the firms of John W. Smith & Company and Arthur E. Phillips & Company, has joined their firm which will in future practise under the name of Dunwoody, Nicholl, Saul & Smith, chartered accountants, 604 Great West Permanent Building, Winnipeg.

OBITUARY

The Late Harold Franklin Brokenshire

The Institute of Chartered Accountants of Ontario announces with deep regret the sudden death in Windsor, Ontario, on 24th April, of Harold Franklin Brokenshire in his 38th year. Mr. Brokenshire took an active interest in the community life and was on his way to a council meeting at Tecumseh, where he held the position of chief magistrate, when he was suddenly stricken.

The late Mr. Brokenshire passed the Final examination of the Institute and was elected to membership 1st February 1938. He was associated with the firm of Brokenshire, Scarff & Company throughout his student years and was made a partner in 1937.

To his wife, daughters and brother, Mr. H. A. Brokenshire, a member, the Institute extends sincere sympathy.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

Everything conspires to give the beginner in accounting a wrong idea of the nature of the Manufacturing Account but in particular he is misled by having this introduced to him not as an asset account but as a clearing account—an additional part of the operating statement peculiar to the industrial concern. It is only when he encounters the techniques of cost accounting and perpetual inventory records that he perceives the Manufacturing Account to be a "real" account in the sense that any other asset account is a "real" account, i.e., an account of values received and values yielded. An account title should indicate the nature of any balance remaining on the account and therefore the cost accountant's "Work in Process Account" is preferable to the "Manufacturing Account" for an account whose balance at any time represents the amount of uncompleted work in the factory. Some students find it helpful to regard the Manufacturing Account as a personal account with the factory manager, he being debited with all values (in the form of raw materials, direct labour and factory services) committed to him for conversion into finished goods, and credited with all values handed over by him to the finished goods stockkeeper. He thus remains debited at any date with values whose conversion into finished goods he has not yet completed, i.e., with the inventory of work in process.

* * *

At bottom the student's difficulties in connection with both the Manufacturing Account and the Gross Trading Account are due to the pedagogue's habit of dealing first with the physical inventory method of cost determination and only much later divulging the mysteries of the perpetual inventory method. It is at least arguable that the student would make better progress if this order were reversed and he were given to understand that perpetual inventory methods were the normal thing and physical inventory methods merely a survival from the day when

accounting was content to record what had happened without exercising any control over what did happen. The Manufacturing Account and Gross Trading Account as "clearing" accounts for *deducing* respectively the cost of goods manufactured and the cost of goods sold then give place naturally to a Work in Process Account and a Finished Goods Account whose normal operation provides these desired figures of cost.

* * *

Entirely unrelated to the pedagogical matters discussed above but arising out of the preparation of the Manufacturing Account is the failure of some students to grasp the distinction between raw materials and work in process with the result that in arriving at the cost of raw materials used they adjust, on purchases of raw materials, not only the opening and closing inventories of raw materials but also the inventories of work in process. These students do not realize that work in process is compounded of raw materials, direct labour and factory service (in unstated proportions) and that accordingly inventories of work in process cannot logically be adjusted on any one element of cost but must be adjusted on the combined total of all three elements—to arrive at the cost of goods whose manufacture was completed during the period.

The very exceptional (but still occasional) student who introduces inventories of finished goods into the Manufacturing Account and produces on that account an end figure which represents the cost of goods sold instead of the cost of goods manufactured is in need, not of enlightenment on fine points, but of an entirely new approach to his accounting studies.

PROBLEMS AND SOLUTIONS

EXAMINATIONS OF THE PROVINCIAL INSTITUTES

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

INTERMEDIATE EXAMINATION, DECEMBER 1941

ACCOUNTING II, QUESTION 4 (35 marks)

The A Company Limited was formed during the latter part of December 1939 and began constructing its buildings on 2nd January 1940.

The trial balance at 31st December 1940 is presented herewith, together with quarterly operating statements and construction summary as prepared by the company's bookkeeper.

You are required to prepare:

(a) Balance sheet at 31st December 1940

(b) Profit and loss statement for the year ending 31st December 1940

Trial Balance at 31st December 1940

Land	$ 50,000	
Buildings	500,000	
Machinery	750,000	
Accounts receivable	125,000	
Cash	7,500	
Capital stock—5,000 common shares of $100 each		$ 500,000
First mortgage 6% twenty-year bonds dated 1st January 1940 $500,000 par value issued		450,000
Bank loan		250,000
Five-year 7% debentures, dated 1st January 1940		250,000
Accounts payable		100,500
Sales		250,000
Purchases, raw material for manufacturing	212,500	
Operating expenses, factory	75,000	
Depreciation on buildings, 2%	10,000	
Depreciation on machinery and equipment 10%	75,000	
Reserve for depreciation		85,000
Officers' salaries	15,000	
Salesmen's salaries	10,000	
Office salaries	5,000	
Interest on bonds	30,000	
Interest on debentures	17,500	
Interest on bank loan	3,000	
	$1,885,500	$1,885,500

Operating Statements

Three months ending—	31st Mar.	30th June	30th Sept.	31st Dec.	Yr. 1940
Sales	....	....	....	$250,000	$250,000
Closing inventory	....	....	$100,000	125,000	125,000
			$100,000	$375,000	$375,000
Raw material purchased	....	....	$100,000	$112,500	$212,500
Opening inventory	....	....	....	100,000	....
Operating expenses, factory	....	....	....	75,000	75,000
Officers' salaries	$ 3,750	$ 3,750	3,750	3,750	15,000
Salesmen's salaries ..	....	....	....	10,000	10,000
Office salaries	500	500	1,000	3,000	5,000
Interest on bonds	7,500	7,500	7,500	7,500	30,000
Interest on debentures	4,375	4,375	4,375	4,375	17,500
Interest on bank loan..	....	....	....	3,000	3,000
	$ 16,125	$ 16,125	$116,625	$319,125	$368,000
Loss	$ 16,125	$ 16,125	$ 16,625	....	....
Profit	....	....	....	$ 55,875	$ 7,000

Construction Summary

Buildings	$250,000	$250,000	....	....	$500,000
Machinery and equipment	....	250,000	$500,000	....	750,000

The buildings were fully completed on 30th June 1940 and were used for the next three months for assembling the machinery and equipment, which was completely installed by 30th September 1940, when the company commenced operations.

Officers and clerks were wholly engaged in supervising and recording construction work to 30th September 1940.

The following rates of depreciation are considered adequate:

Buildings, 2% per annum

Machinery and equipment, 10% per annum.

Inventories at 31st December 1940 were as follows:

Raw materials, $50,000
Goods in process, $35,000
Finished goods, $40,000.

SOLUTION

THE X COMPANY LIMITED

Balance Sheet as at 31st December 1940

Current Assets

Cash on hand		$ 7,500.00
Accounts receivable		125,000.00
Inventories—Raw materials	$ 50,000.00	
Goods in process	35,000.00	
Finished goods	40,000.00	125,000.00
Total current assets		257,500.00

Fixed Assets			
Land		50,000.00	
Buildings	$533,500.00		
Less Reserve for depreciation	5,335.00	528,165.00	
Machinery and equipment	769,917.50		
Less Reserve for depreciation	19,247.94	750,669.56	1,328,834.56
Deferred charges—Bond discount			47,500.00
			$1,633,834.56
Current Liabilities			
Bank loan			$ 250,000.00
Accounts payable			100,500.00
Total current liabilities			350,500.00
Funded Debt			
6% 20 year bonds due 1st January 1960		$500,000.00	
7% 5 year debentures due 1st January 1945		250,000.00	750,000.00
Capital and Surplus			
Capital — Common (Authorized, issued and fully paid) 5,000 shares of $100 each		500,000.00	
Surplus		33,334.56	533,334.56
			$1,633,834.56

THE X COMPANY LIMITED

Statement of Profit and Loss for the Year ended 31st December 1940

Sales		$250,000.00
Cost of sales:		
Cost of goods manufactured—per Manufacturing Statement	$224,415.44	
Less Inventory of finished goods, 31st December 1940	40,000.00	184,415.44
Gross trading profit		65,584.56
Selling and administration expenses:		
Officers' salaries	3,750.00	
Salesmen's salaries	10,000.00	
Office salaries	3,000.00	16,750.00
Net trading profit		48,834.56
Financial expenses:		
Bond interest and discount	8,125.00	
Debenture interest	4,375.00	
Bank interest	3,000.00	15,500.00
Net profit for the year carried to Surplus Account		$ 33,334.56

THE X COMPANY LIMITED

Statement of Manufacturing for Year ended 31st December 1940

Raw materials:		
Purchases during the year	$212,500.00	
Less Inventory 31st December 1940	50,000.00	$162,500.00
*Direct labour		60,000.00
Manufacturing overhead expenses:		
*Operating expenses, factory	15,000.00	
Depreciation of buildings	2,667.50	
Depreciation of machinery	19,247.94	36,915.44
		259,415.44
Less Inventory of goods in process 31st December 1940		35,000.00
Cost of goods manufactured		$224,415.44

Statement figures

Buildings—	per trial balance		$500,000.00
	Add—Charged for 6 months to 30th June		32,250.00
	Bond discount (½ of $2,500.00)		1,250.00
	Balance sheet figure		$533,500.00
Machinery—	per trial balance		$750,000.00
	Add—Charges for third quarter		16,625.00
	Bond discount (¼ of $2,500.00)		625.00
	Depreciation on Buildings (½ of $5,335.00)		2,667.50
	Balance sheet figure		$769,917.50
Bond Discount—	20 year bonds to be written off $2,500 per year		$ 50,000.00
	Charged to buildings (6 months)	$1,250.00	
	Charged to machinery (3 months)	625.00	
	Charged to profit and loss (3 months)	625.00	2,500.00
	Balance sheet figure		$ 47,500.00
Depreciation of Buildings—	6 months at 2% per annum on $533,500		$ 5,335.00
	Charged to machinery (3 months)	$2,667.50	
	Charged to profit and loss (3 months)	2,667.50	5,335.00
Depreciation of Machinery—	10% per annum on $769,917.50 for 3 months		$ 19,247.94

*For purposes of this solution it is assumed that the item "Operating expenses, factory $75,000.00" contains direct labour $60,000.00 and manufacturing overhead expenses $15,000.00.

PROBLEM II

FINAL EXAMINATION, DECEMBER 1941

Accounting III. Question 1 (35 marks)

From the following trial balance and other data prepare:

1. Columnar work sheets showing consolidation of the accounts of Dominion Airways Ltd., a Dominion company, and its two subsidiary companies, Eastern Airways Ltd. and Western Airways Ltd.
2. Consolidated balance sheet
3. Consolidated statement of profit and loss
4. Consolidated statement of surplus.

Trial Balance, 30th September 1941

	Dominion Airways Ltd.	Eastern Airways Ltd.	Western Airways Ltd.	Northern Airways Ltd.
Debits				
Cash on hand and in banks	$ 200,000	$ 30,000	$ 5,000	$ 10,000
Accounts receivable	5,000	250,000	150,000	60,000
Advances to subsidiary and allied companies	200,000			
Inventories of supplies		10,000	10,000	5,000
Prepaid expenses		15,000	10,000	3,000
Investments in subsidiary and allied companies	2,300,000			
Fixed assets	10,000	890,000	690,000	320,000
Goodwill		600,000	400,000	250,000
Costs and operating expenses	10,000	1,000,000	650,000	240,000
Remuneration of executive officers	15,000	10,000	10,000	8,000
Directors' fees	10,000	5,000	5,000	
Legal expenses	5,000	3,000	2,000	
Interest on bonds	25,000	30,000	25,000	5,000
Depreciation	1,000	45,000	24,000	19,000
Provision for Dominion and provincial taxes		50,000	35,000	8,000
Dividends paid	110,000	60,000	75,000	35,000
	$2,891,000	$2,998,000	$2,091,000	$963,000
Credits				
Accounts payable		$ 60,000	$ 38,000	$ 10,000
Reserve for bad debts	$ 500	33,000	8,000	5,000
Advances by Dominion Airways Ltd.		120,000	50,000	30,000
Reserves for Dominion and provincial taxes		50,000	35,000	8,000
Reserves for depreciation	5,000	250,000	170,000	40,000
Bonds payable	500,000	600,000	500,000	100,000
Capital stock preferred	1,000,000			
Capital stock common	500,000	500,000	450,000	350,000
Revenues from operations		1,200,000	800,000	300,000
Interest earned on bonds	60,000			

Profit on sale of capital assets		10,000		
Dividends received	127,000			
Surplus 1st October 1940	698,500	175,000	40,000	120,000
	$2,891,000	$2,998,000	$2,091,000	$963,000

The investments of Dominion Airways Ltd. in subsidiary and allied companies are made up of bonds and shares valued at original cost as follows:

Eastern Airways Ltd.	—bonds	$ 600,000
	—shares, par value $500,000	600,000
Western Airways Ltd.	—bonds	500,000
	—shares, par value $360,000	400,000
Northern Airways Ltd.	—bonds	100,000
	—shares, par value $70,000	100,000
		$2,300,000

The surplus accounts of Eastern Airways Ltd. and Western Airways Ltd. represent surplus earned subsequent to purchase of the shares by Dominion Airways Ltd.

Included in the revenues of Eastern Airways Ltd. is a credit for rental of airports charged to Western Airways Ltd. for use of airport facilities amounting to $25,000.

SOLUTION

1. *Work sheets for consolidation of the accounts of Dominion Airways Ltd. and its subsidiaries*

Balance Sheet as at 30th September 1941

ITEM	Dominion Airways Ltd.	Eastern Airways Ltd.	Western Airways Ltd.	Eliminations	Inter-Co. Investments in excess of book value	Total
Assets						
Cash on hand and in banks	$ 200,000	$ 30,000	$ 5,000			$ 235,000
Accounts receivable	5,000	250,000	150,000			405,000
Advances to subsidiary & allied companies	200,000			$—170,000		30,000
Inventories of supplies		10,000	10,000			20,000
Prepaid expenses		15,000	10,000			25,000
Investments in subsidiary & allied companies						
Eastern Airways Bonds	600,000			—600,000		
Shares	600,000			—500,000	$—100,000	
Western Airways Bonds	500,000			—500,000		
Shares	400,000			—360,000	— 40,000	
Northern Airways Bonds	100,000					100,000
Shares	100,000					100,000
Fixed assets	10,000	890,000	690,000			1,590,000
Goodwill		600,000	400,000		+140,000	1,140,000
	$2,715,000	$1,795,000	$1,265,000	—	—	$3,645,000
Liabilities						
Accounts payable		$ 60,000	$ 38,000			$ 98,000
Reserves for bad debts	$ 500	33,000	8,000			41,500
Advances by Dominion Airways		120,000	50,000	$—170,000		
Reserves for Dominion and Provincial Taxes		50,000	35,000			85,000
Reserves for depreciation	5,000	250,000	170,000			425,000
Bonds payable	500,000	600,000	500,000	—1,100,000		500,000
Capital stock preferred	1,000,000					1,000,000
Common (D. A. Ltd.)	500,000					500,000
Common (Subsidiary)		500,000	450,000	—860,000		90,000
Surplus—Minority				+ 2,800		2,800
Surplus	709,500	182,000	14,000	— 2,800		902,700
	$2,715,000	$1,795,000	$1,265,000	—	—	$3,645,000

Profit and Loss for Year ending 30th September 1941

ITEM	Dominion Airways Ltd.	Eastern Airways Ltd.	Western Airways Ltd.	Eliminations		Total
Revenues from operations		$1,200,000	$ 800,000	— 25,000		$1,975,000
Interest received on bonds	$ 60,000			— 55,000		5,000
Profit on sale of capital assets		10,000				10,000
Dividend received	127,000			—120,000		7,000
	$ 187,000	$1,210,000	800,000			$1,997,000
Cash and operating expenses	10,000	1,000,000	650,000	— 25,000		1,635,000
Remuneration of executives	15,000	10,000	10,000			35,000
Directors fees	10,000	5,000	5,000			20,000
Legal expenses	5,000	3,000	2,000			10,000
Interest on bonds	25,000	30,000	25,000	— 55,000		25,000
Depreciation	1,000	45,000	24,000			70,000
Provision for Dominion and Provincial taxes		50,000	35,000			85,000
	$ 66,000	$1,143,000	$ 751,000			$1,880,000
Net profit	$ 121,000	$ 67,000	$ 49,000	$—120,000		$ 117,000
Surplus					Interest of Minority Shareholders	
Balances, 1st October 1940	$ 698,500	$ 175,000	$ 40,000		$— 8,000	$ 905,500
Net profit	121,000	67,000	49,000	$—120,000	— 9,800	107,200
	819,500	242,000	89,000	—120,000	—17,800	1,012,700
Dividends—Intercompany		60,000	75,000	—120,000	—15,000	
Dividend	110,000					110,000
	$ 709,500	$ 182,000	$ 14,000	—	$— 2,800	$ 902,700

2. DOMINION AIRWAYS LTD. AND SUBSIDIARY COMPANIES

in which the parent company's interest in the common stock is 80% or more

CONSOLIDATED BALANCE SHEET
30th September 1941

Assets

Current assets			
Cash on hand and in banks		$ 235,000	
Accounts receivable	$ 405,000		
Less: Reserves for bad debts	41,500	363,500	
Inventories of supplies		20,000	
Prepaid expenses		25,000	$ 643,500
Investments in and advances to allied company			
Bonds and shares		200,000	
Advances		30,000	230,000
Fixed assets		1,590,000	
Less: Reserves for depreciation		425,000	1,165,000
Goodwill			1,140,000
			$3,178,500

Liabilities

Current liabilities		
Accounts payable	$ 98,000	
Reserves for Dominion and Provincial taxes	85,000	$ 183,000
Bonds payable		500,000
Interest of minority shareholders in capital and surplus of subsidiary companies		92,800
Capital stock and surplus		
Preferred	1,000,000	
Common	500,000	
	1,500,000	
Surplus	902,700	2,402,700
		$3,178,500

3. CONSOLIDATED STATEMENT OF PROFIT AND LOSS
for the year ended 30th September 1941

Revenues from operations	$1,975,000
Cost and operating expenses	1,635,000
Profits from operations before providing for depreciation, interest, etc.	340,000
Dividend received	7,000
Interest earned	5,000
Profit on disposal of capital assets	10,000
	362,000

Less		
Remuneration of executive offices	$ 35,000	
Directors fees	20,000	
Legal expenses	10,000	
Interest on bonds	25,000	
Depreciation	70,000	160,000
Profit before Dominion and Provincial taxes ..		202,000
Deduct: Dominion and Provincial taxes		85,000
Net profit		117,000
Deduct: Proportion thereof applicable to interest of minority shareholders		9,800
Balance of net profits		$ 107,200

4. CONSOLIDATED STATEMENT OF SURPLUS

for the year ended 30th September 1941

Surplus at 15th October 1940	$ 905,500
Add	
Net profits for the year ended 30th September 1941	107,200
	$1,012,700
Deduct	
Dividends paid	110,000
Surplus at 30th September 1941	$ 902,700

PROBLEM III

FINAL EXAMINATION, DECEMBER 1941

Accounting III. Question 4 (20 marks)

The Anglo Canadian Tool Company Limited made a voluntary assignment on 30th September 1940. The assets and liabilities shown by the custodian's inventory taken at that date were as follows:

Cash on hand	$ 200
Accounts receivable	7,000
Stock on hand	12,500
Real estate and buildings (book value)	168,000
Machinery and equipment (book value)	32,000
Bank advance (secured by accounts receivable of $3,500 specifically assigned)	15,000
Trade creditors	25,000
Wages payable (one week immediately prior to assignment)	1,000
Sales tax	300
Mortgage on real estate and buildings	70,000
Accrued interest on the mortgage	1,050
Capital stock—preferred as to participation in assets on liquidation—issued	50,000
Capital stock—common—issued	50,000

As there were contracts in progress the trustee was authorized to carry on the business. The estate was finally closed out at 31st

October 1941, after completion of the contracts and sale of the real estate, buildings and machinery and equipment.

The transactions of the trustee were as follows:

Realized on sale of real estate and buildings in excess of amount of mortgage	$ 40,000
Paid interest on mortgage	5,250
Realized on sale of machinery and equipment	5,000
Received rentals from building	600
Collected accounts receivable not assigned	2,500
Received from operation of the business	60,000
Expended in operation of the business	50,000
Received interest on bank balances	300
Paid balance of bank advance after credit of $3,000 for collection of assigned accounts receivable and less ½% levy to be paid to the superintendent of bankruptcy	11,940
Paid secured creditors in full	
Paid unsecured creditors in full less ½% levy to be paid to superintendent of bankruptcy	24,875
Paid expenses of administration, inspector's and trustee's fees	5,500
Paid levy of superintendent of bankruptcy	185
Distributed the balance to holders of preferred shares.	

Required:

Prepare a statement of receipts and disbursements by the trustee and a statement of deficiencies on operations and realization showing surplus distributable to the shareholders.

SOLUTION

ESTATE OF THE ANGLO CANADIAN TOOL COMPANY LIMITED

Trustee's Statement of Receipts and Payments

For the Period from 30th September 1940 to 30th September 1941

Receipts			
Cash on hand 30th September 1940		$ 200	
Rentals received		600	
Accounts receivable collected		2,500	
Realized on sale of machinery and equipment		5,000	
Realized on sale of real estate and building		40,000	
Receipts from operation of business		60,000	
Interest on bank balances		300	$108,600
Disbursements			
Expenditures of operating the business		50,000	
Paid to secured creditors			
Wages	$ 1,000		
Sales tax	300		
Mortgage interest	5,250	6,550	
Paid to unsecured creditors			
Bank	11,940		
Ordinary creditors	24,875	36,815	

Paid administrative, trustee expenses, etc.			
Levy, Superintendent of Bankruptcy	185		
Inspector's and trustee's expenses...	5,500	5,685	99,050
Balance available for distribution to preferred shareholders—19.1% of par value of shares ..			$ 9,550

No amount is available for distribution to common shareholders.

ESTATE OF THE ANGLO CANADIAN TOOL COMPANY LIMITED

Statement Showing Deficiencies on Operations and Realization

At 30th September 1941

ASSETS AND LIABILITIES as per custodian's inventory at 30th September 1940.			
Assets			
Cash on hand		$ 200	
Accounts receivable		7,000	
Stock on hand		12,500	
Real estate and building		168,000	
Machinery and equipment		32,000	$219,700
Liabilities			
Bank advances		$ 15,000	
Trade creditors		25,000	
Wages payable		1,000	
Sales tax payable		300	
Mortgage payable		70,000	
Accrued interest		1,050	112,350
Apparent surplus available for shareholders			107,350
Add			
Interest received on bank balances		300	
Rentals received		600	900
			108,250
Deduct			
Deficiency on operations			
Stock on hand 30th September 1940	$ 12,500		
Expenditures on operations	50,000		
	62,500		
Receipts from operations	60,000	2,500	
Deduct			
Deficiency on realization			
Accounts receivable	$ 1,500		
Real estate and buildings	58,000		
Machinery and equipment	27,000	86,500	
Interest on mortgage		4,200	
Expenses of inspectors and trustee		5,500	98,700
Actual surplus available for shareholders at 30th September 1941			$ 9,550